University of Alberta

Directors' Personal Liability in Tort to Third Parties

by

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This thesis is dedicated to

the All Knowing God, the fountain of knowledge and to all who strive for that high standard.

ABSTRACT

Corporate law is founded on the common law principle of separate legal personality while tort law has a general rule that persons are responsible for their own conduct. The artificial nature of the corporation and the need to operate through human agents raise the conflicting duty of monitoring directorial powers while ensuring that directors do not bear the brunt of all corporate wrongs. This results in the contending issues arising from upholding the separate personality of corporations while also holding everyone answerable for his tortious acts.

This thesis reviews the competing foundational principles of corporations and tort law as it affects directors' personal liability to third parties and the viability of the two lines of authority employed by Canadian courts to deal with the question. It concludes that current approaches are inconsistent and suggests an alternative framework founded on culpability for determining directors' personal liability for torts against third parties.

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PART I INTRODUCTION

The role played by corporate directors in the success of the business corporation cannot be over-emphasized. This is reflected in the special recognition they receive in corporate statutes.[1] However, the latitude accorded directors to enable them to achieve business objectives brings with it legal questions of liability for corporate wrongs. In other words, the concept of incorporation and the machinery required to run an enterprise create legal controversy as to when directors should be held responsible for the corporate wrongs they commit while presumably acting in the best interest of the corporation.

This controversy emerges because tort law operates by the general rule that persons are responsible for their own conduct.[2] Invariably, the underlying principle of tort that perpetrators should be held accountable and responsible for their actions becomes difficult to enforce at face value in situations where, as Professor C. Nicholls points out, such persons "are acting not in pursuit of their own personal goals and objectives, but in the pursuit of the goals and objectives of another artificial person...".[3] In other words, enforcing the principle of liability against directors will "pit the aims of tort law squarely against those of

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[1] *Canada Business Corporations Act,* R.S.C. 1985, c. C-44 [CBCA], ss. 18(1)(b), 18(1)(d), 18(1)(e) and 102. See also *Alberta Business Corporations Act,* R.S.A. 2000, c. B-9, s. 101 [ABCA] and *Ontario Business Corporations Act,* R.S.O. 1990, c. B-16, s. 115 [OBCA].

[2] *Adga Int'l Ltd. v. Valcom Ltd.* [1999] 43 O.R. (3d) 101; O.J. No. 27; 168 D.L.R. (4th) 351 at 357 (C.A.) [*Adga*].

[3] Christopher Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (2001) 35 Can. Bus. L. J. 1 at 37.

company law".[4] The question arising is should the individuals purportedly acting for the corporation also have personal liability for the torts arising in the course of performing their duties?

Current case law in Canada is inconsistent regarding when directors are personally liable in tort to third parties. The sway in decisions handed down by Canadian courts stems from the conflicting foundational assumptions of tort law and corporate law. This state of affairs in the law is unsatisfactory because directors deserve to know with reasonable certainty when they will be personally liable for their torts and when they will not. As Oliver Wendell Holmes broadly observes "people want to know under what circumstances and how far they will run the risk of coming against what is so much stronger than themselves ...".[5] This includes directors too.

On the one hand, there is the view that directors should only rarely be liable in tort because, in acting for the corporation, they are not acting in a personal capacity. Since a corporation is a separate legal entity,[6] only the corporation should be liable. In this way, the tenets of corporations law are

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[4] Ross Grantham, "Commentary on Goddard" in R. Grantham and Charles Rickett, eds., *Corporate Personality in the 20th Century* (Oxford: Hart Publishing, 1998) 65 at 68. Note however that some commentators have argued that there is no conflict between the two areas of law. See Robert Flannigan, "The Personal Tort Liability of Directors" (2002) 81 Can. Bar Rev. 280.

[5] Oliver Wendell Holmes, "The Path of the Law" (1897) 10 Harv. L. Rev. 457 at 457.

[6] *Salomon v. Salomon,* [1897] A.C. 22 (H.L.) [*Salomon*] (Where the court held that unsecured creditors of a company cannot claim against the major shareholder of the company as they could only blame themselves for not adequately protecting their investment.). See also CBCA, s. 15. See also Robert Yalden *et al., Business Organizations: Principles, Policies and Practice* (Toronto: Edmond Montgomery Publications Limited, 2008) at 133. This essential principle runs to the core of the corporate entity and therefore plays an important role in determination of questions of law involving the corporate entity.

regarded as prevailing over the principles of tort law.[7] Judges driven by corporate law values are reluctant to impose liability. On a related front, this perspective is aligned with the law and economics approach which regards economic efficiency as its informing value.

On the other hand, there is the view that directors should be liable for their own torts and corporate law should have no say in the matter.[8] According to Neil Campbell and John Armour:

> [T]he liability questions should be resolved simply by applying the established rules relating to the particular head of liability with due regard paid to the defendant's capacity as an agent. It should make no difference that the defendant was an agent *for a corporation.*[9]

Where a judge's decision is driven by tort law values, it leads to increased liability. This orientation is aligned in part at least with the theoretical perspective called progressive movement which elevates fairness as the law's informing value.

In view of the above, it therefore becomes crucial that there be a standardized body of rules – judicial or statutory - guiding this area of law. Directors should be able to know when they will be held accountable for their actions; third parties should know whom to sue in the event of a tortious claim; and courts should be afforded ample resources in coming to a decision.

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[7] Ross Grantham & Charles Rickett, "Directors' Tortious Liability: Contract, Tort or Company Law?" (1999) 62 Mod. L. Rev. 133 at 139. See also Ross Grantham "The Limited Liability of Company Directors" (2007) L.M.C.L.Q. 362 at 365. Both legal commentators opine that directors' personal liability will frustrate the aims and objectives of corporations law and suggest that this is one of the reasons why the corporate entity was formed, namely to avoid these kinds of situations.

[8] Christopher C. Nicholls, *Corporate Law* (Toronto: Edmond Montgomery Publications Limited, 2005) at 220.

[9] Neil Campbell and John Armour, "Demystifying the Civil Liability of Corporate Agents" (2003) 62 Cambridge L. J. 290 at 291-292.

This thesis argues that the inconsistencies beguiling Canadian corporate jurisprudence can be attributed to a lack of a coherent theoretical perspective for balancing tort law and corporations law. It suggests an approach to the question of directors' liability which balances the corporations and tort outlook. The theory advanced articulates a test of liability based on the notion of culpability. The degree of director's culpability shall be employed as a yardstick or trigger for determining when personal liability should be visited on the director and when it should not. In other words, the more culpable a director is the more likely liability should flow; the less culpable, the less likely liability should flow.

In order to defend such an approach, this thesis is divided into 5 parts. Part II reviews the theoretical justifications for each area of law – corporations law and tort law - and concludes by setting out a balanced theory that is applicable to both. Part III considers the Canadian situation and how courts have attempted to resolve the question. A special emphasis is given to the two lines of authority currently operative in Canada and the challenges trailing their application. Part IV carries out a practical adoption of the theory advanced in Part II in that the success or otherwise of the theory is measured against decided Canadian cases. Part V offers a brief conclusion.

PART II TOWARDS A THEORETICAL JUSTIFICATION FOR DIRECTORS' LIABILITY IN TORT – A PRAGMATIC APPROACH

2.1 General Introduction

In order to achieve a coherent framework for resolving the question of directors' personal liability in tort to third parties, it is essential to first consider the foundational problems arising from principles governing corporations law and tort law. This part therefore considers the concept of personal liability in the light of the general objectives of tort law, especially deterrence and compensation. It also highlights the objectives of corporate law, including creation of a juristic person (and the concomitant principle of limited liability) as well as profit maximization. The effect of a dispensation of personal liability of directors will be considered in the light of the corporate goals. A section is also devoted to arguments advanced by the law and economies and progressive schools, respectively, on the issue in contention. The values of efficiency and fairness will emerge in this part as a means of ensuring that justice is served when assessing a director's tortious liability. This part will also endeavour to show how the concept of culpability can be employed as a means of balancing the often competing goals of tort law and corporations law. The degree of director's culpability becomes a yardstick or trigger for determining when personal liability should attach.

2.2 Tort Law and Personal Liability

2.2.1 Introduction

The law of tort can be likened to an octopus with numerous tentacles reaching into different facets of human life. According to Mr. Justice Linden, it "hovers over virtually every activity of modern society…[and is] therefore a subject of abiding concern not only to the judges and lawyers who must administer it but also to the public at large, whose every move is regulated by it."[10] The term "tort" has been defined as "a civil wrong, other than breach of contract, which the law will redress by an award of damages."[11]

Attempt has been made by various legal theorists to characterize tort law. However, the exercise has not been a smooth one as it is still a source of debate.[12] Notwithstanding the ongoing debate, the notion of personal responsibility is perennially fundamental to the achievement of tort goals and functions. The next few paragraphs will consider the generally recognized functions of tort law with special emphasis on those that may affect corporate directors.

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[10] Allen M. Linden and Bruce Feldthusen, *Canadian Tort Law*, 8th ed. (Markham: LexisNexis Butterworths, 2006) at 1.

[11] John G. Fleming, *The Law of Torts*, 9th ed. (Sydney: The Law Book Company Limited, 1998) at 1 cited by Linden, *ibid.* at 2. See also Lewis N. Klar, *Tort Law*, 3rd ed. (Toronto: Thomson Carswell, 2003) at 1. This simplified definition is merely for foundational purposes and I do not intend to enter into the debate on the definition of tort.

[12] There is an existing debate on whether or not tort law should be measured and understood from a functional or doctrinal/ethical perspective. Peter Cane refers to the two major groups as the Functionalists and the Essentialists. Peter Cane, *The Anatomy of Tort Law* (Oxford: Hart Publishing, 1997) at 209. See Ernest Weinrib, "Understanding Tort Law" (1989), 23 Val. U.L. Rev. 485 at 488 and Ernest Weinrib, *The Idea of Private Law* (Cambridge, Massachusetts: Harvard University Press, 1995) at 4-6. See also Phillip H. Osborne, *The Law of Torts*, 3rd ed. (Toronto: Irwin Law, 2007) at 12.

2.2.2 Functions of Tort Law Reconsidered

It is often said that when the purpose of a thing is unknown, its abuse is inevitable. In view of such a statement, this section will attempt to identify the major purposes of tort law in order to establish the importance or otherwise of personal responsibility.[13]

According to Peter Cane, "[s]eeking to understand tort law without referring to its functions is … like seeking to understand traffic lights without knowing what they are for."[14] What then is the goal of tort law? What is the basis of tort liability? To use the words of Glanville Williams, what is "the end or social function or *raison d'être* of the law of tort, and particularly of the action in tort for damages"?[15] Legal theorists have put forward several suggestions regarding the functional purpose of tort law. Two important scholars in the area of tort law have rendered very reliable assistance in setting out a compilation of functions of tort law.[16] Mr. Justice Linden[17] and Professor Lewis Klar[18] have both identified many purposes of tort law, albeit recognizing the difficulty posed by a generalization of tort law purposes.[19] Professors

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[13] Measuring tort principles from a functional perspective is not a new innovation. In fact attempts have been made by commentators and legal writers to resolve the tort question from the functional perspective. See Linden, *supra* note 10. See also Geoffrey Samuel, *Cases and Materials on Tort* (Exeter: Law Matters Publishing, 2006) at 44.

[14] Cane, *supra* note 12 at 212. Justice Linden also reiterated this position when he commented that "[a] more promising description of tort law can be obtained by focusing on function". See Linden and Feldthusen, *supra,* note 10 at 2.

[15] Glanville Williams, "The Aims of the Law of Tort" (1951) 4 Curr. Legal Probs. 137.

[16] The various categorizations are not limited to those suggested by these two alone. See also Glanville Williams' list, namely Appeasement, Justice, Deterrence and Compensation. Williams, *ibid.* at 138 - 153.

[17] Linden, *supra* note 10 at 4 – 30.

[18] Klar, *supra* note 11 at 9 – 18.

[19] According to Klar, tort law protects a diversity of interests dependent on "the area under review, the type of injury and conduct and, to a lesser extent, the philosophy and attitude of the law maker." Klar, *ibid.* at 9. This he attributes to the origin of tort law, as principally judge-made

Markesinis and Deakin rightly observe that the functions of tort law is not static and has therefore seen an evolution over a period of time dependent on the socio-economic and philosophical trends of the day.[20] But notwithstanding these numerous view and perspectives, the following section will show that legal theorists generally agree on education, ombudsman, compensation, and deterrence, as being functions of tort law.[21] A brief analysis of each function follows.

The educational role of tort in a society entails using tort law to condemn anti-social actions and promote good actions. With imposition of liability on a tortfeasor, tort law "publicly marks the defendant as a 'wrong doer' and vindicates the plaintiff's complaint"[22] thereby fostering community feelings about common values. This function ensures that people are kept abreast of what is considered acceptable and when certain acceptable actions become unacceptable. In other words, tort law sometimes takes on school and church roles, by restating certain moral principles guiding individual members of a society in their relationship with one another.[23] For example, the medical

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laws. Tort law, he says, "reflect different and often inconsistent values and concerns" arising from idiosyncratic ideologies and philosophies of judges and legislators over time. Klar, *ibid.* at 9. To Justice Linden, tort law is multi dimensional and pluralistic thereby providing us with a gamut of purposes, which are for the most part unharmonious, and sometimes exhibiting conflicts within themselves. According to him, some purposes of tort law are "unrecognized, dimly perceived, or even vehemently denied. Some are achieved only indirectly and some not at all." Linden, *supra* note 10 at 2.

[20] Simon Deakin, Angus Johnston and Basil Markesinis, *Markesinis and Deakin's Tort law*, 5th ed. (Oxford: Clarendon Press, 2003) 37–41. Markesinis, Johnston and Deakin list appeasement, justice, punishment, deterrence, compensation and loss spreading as having at one time or the other been recognized as the aim of tort law, with one gaining more importance than the rest.

[21] Note also Linden's psychological function and market deterrence, Linden, *supra* note 10 at 16-22 and Klar's justice function, Klar, *supra* note 11 at 12-15.

[22] Linden, *supra* note 10 at 15.

[23] Linden, *ibid.* at 16.

profession is careful that its members are kept "informed concerning their responsibilities under tort law."[24]

As an ombudsman, tort law provides an injured person with sufficient power to bring political, economic and intellectual power holders to book.[25] Without such an avenue, a person in a stronger position of authority, whether political, economic or intellectual, is likely to tread on the weaker plaintiff. The current legal dispensation reveals many successful prosecutions of claims against government officials and business corporations,[26] all attributable to the ombudsman function of tort law.

Thirdly, tort law sets out to deter socially reprehensible actions. It ensures that individual actions of members of a society create a safe habitation for all the members. In other words, tort law prevents harm because it seeks to control the actions of members of the society. Tort liability would not only discourage individual tortfeasors but also dissuade others from charting the same course. Thus it seeks to correct and also prevent future tortious actions by threatening potential wrongdoers with liability for their wrongful actions. Due to the common roots of tort law and criminal law, legal writers have compared this deterrence role of tort law to that of criminal law.[27] Credence is lent to this position by the fact that courts can impose some forms of punitive damages for the commission of a tort in order to punish the offender or to sound a note of

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[24] Klar, *supra* note 11 at 17.
[25] Linden, *supra* note 10 at 22.
[26] Klar, *supra* note 11 at 17-18.
[27] See Linden, *supra* note 10 at 7. Justice Linden refers to Jeremy Bentham, John Austin, John Salmond and Lord Mansfield as some of the many legal theorists who have viewed tort law to be like criminal law. See also Williams, *supra* note 15 at 138.

warning to other prospective injurers. In fact it has been stated that "judges view tort law as a 'whip that makes industry safer and saner'".[28]

Also, tort law has a compensatory role[29] which has been rated as one of its most important functions.[30] For some theorists, this is in fact the primary focus and "legitimate task" of tort law.[31] For example, John Fleming opines that tort law is aimed at adjusting losses and compensating injuries arising from interrelation among members of a society.[32] Invariably, this loss adjustment and injury compensation is achieved by ensuring that those who cause harm to others are made to pay damages to such persons for the loss incurred. Commenting on the term "compensation", Robert Goodwin explains that "compensation serves to right what would otherwise count as wrongful injuries to persons or their property."[33] Therefore, tort law also sets out to compensate the victim for her injury. In other words, the major focus is not as much on the defendant tortfeasor's fault as it is on reimbursing the plaintiff tort victim for loss incurred.

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[28] Linden, *ibid.* at 7. See also Little, Joseph W., "Up With Torts" (1987) 24 San Diego L. Rev. 861 at 868 while commenting on the proper role of tort law.

[29] Klar, *supra* note 11 at 11. Williams distinguishes the compensatory role of tort law from the ethical compensation mentioned in his enumeration of functions of tort law. According to him, this general compensatory aim of tort requires no proof of fault on the part of the defendant while the ethical compensation requires that fault be shown on the part of the defendant. See Williams, *supra* note 15 at 151.

[30] R. G. Frey and Christopher W. Morris, *Liability and Responsibility: Essays in Law and Morals* (Cambridge: Cambridge University Press, 1991) at 5. See also Linden, *supra* note 10 at 4, where he describes tort law as a compensator.

[31] Klar, *supra* note 11 at 9. See also Linden, *ibid.* at 4.

[32] Fleming, *supra* note 11 at 12. Even Dean C.A. Wright has been quoted to have confirmed that the purpose of tort law is "to adjust losses and to afford compensation for injuries sustained by one person as the result of the conduct of another". See C.A. Wright "Introduction to the Law of Torts" (1944) 8 Cambridge L. J. 238 cited by Linden, *supra* note 10 at 4.

[33] Robert E. Goodin, "Theories of Compensation" in Frey and Morris, *supra* note 30 at 257.

In addition to the above functions, justice has been recognized as an important function of tort law. Tort law aims at ensuring that justice is served between the two contending parties. Williams distinguished between two forms of justice realizable from the facts of the same case. On the one hand, justice may require that the tortfeasor suffer for the wrongs she has committed. That is, she is required to make ethical retribution through her suffering for the wrong committed. In this way, tort law ensures that the person who makes a mess cleans it up.[34] On the other hand, justice may be viewed as ensuring that the victim is restored to as close a place to where he was before he suffered the loss or injury. This amounts to "ethical compensation" for his suffering. Sounding the same note as Williams, Professor Klar states that this justice element involves questions of fairness requiring the perpetrators to also shoulder the necessary repairs.[35]

Williams recognizes another function of tort law which he refers to as "appeasement". This function is psychologically inclined as it targets the state of mind of the injured. According to Williams, tort and crime have a common root and aim of providing a dispute resolution system so that, in the face of an injury, the victim can be appeased through compensation by the wrong-doer. The victim therefore finds satisfaction in making monetary gain and also in seeing the offender's discomfort at being made to pay. This in turn wards off the

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[34] Arthur Ripstein, "Some Recent Obituaries of Tort Law" (1998) 48 U.T.L.J. 561 at 565.
[35] Klar, *supra* note 11 at 12. See also Williams, *supra* note 15 at 140: "One who by his fault has caused damage to another ought as a matter of justice to make compensation".

likelihood of further unrest.[36] Justice Linden also recognizes this psychological function of tort laws achieved by appeasing the victim of a tort. Tort law therefore keeps peace in society by reducing the likelihood of revenge on the part of the victim who finds satisfaction in the damages imposed on the tortfeasor.

Several theorists note that functions of tort law can be reduced to two major functions - compensation and deterrence.[37] This is because deterrence and compensation appear to be the first stages required before one can reach the other goals. For instance, it can be argued that the attainment of justice as a target requires the reparation of wrongs.[38] In other words, it is only after the injured has been returned to the *status quo ante,* or as close to it as possible, that justice can be said to have been served.[39] Also the psychological or appeasement function is also greatly dependent on compensation. This will eventually lead to deterrence as pain suffered by the tortfeasor when he compensates the injured works to deter him from a future occurrence and serve as a lesson to other members of the society to ensure that the societal peace is kept. The same argument can be made for the educational and ombudsman functions. That is, every educational purpose served by tort is dependent on the message delivered

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[36] Williams comments that this function may no longer be as important in modern day age as it used to be in early times. Family feuds and duelings no longer pose societal threats. Williams, *ibid.* at 138.

[37] They have been described as the two major goals of tort law. See John C. B. Goldberg, "Twentieth Century Tort Theory" (2002-2003) 91 Geo. L. J. 512 at 525. See also Weinrib, "Understanding Tort Law", *supra* note 12 at 487. Professor Weinrib notes that compensation and deterrence are the two major goals ascribed to tort law. See also Linden, *supra* note 10 at 4 – 13. See also John Cooke, *Law of Tort,* 8th ed. (England: Pearson Education Limited, 2007) at 12.

[38] Del Vecchio, *Justice* (1924) at 216 cited by Linden, *ibid.* at 4.

[39] See Williams' comments that justice is served by making sure that the perpetrator compensate the victim. Williams, *supra* note 15 at 140.

through imposition of damages on the tortfeasor and for the compensation of the victim.

On this basis, it is more than defensible to conclude that tort law is especially aimed at deterring anti-social conduct and compensating persons injured thereby. In addition, deterrence and compensation are the only two constant functions that can be found in the different list of functions compiled by tort law commentators.[40] In support of the two "golden" functions of tort law,[41] John Golberg opines that:

> The nature of the compensatory remedy demonstrates that the *ad hoc* legislation undertaken within tort cases is inherently capable of promoting only two goals: deterrence of antisocial conduct and compensation for those who have been injured.[42]

This conclusion leads us to the importance of personal liability to achieving these two major objectives of tort law.[43] This matter forms the basis of the next section.

2.2.3 Directors' Personal Liability and the Goals of Tort Law

This section considers whether holding directors liable for corporate torts furthers the goals of tort law or not. In other words, would a failure to hold directors personally liable for corporate torts in any way threaten the potency of tort law as a compensator or as a deterrent?

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[40] See Weinrib, *The Idea of Private Law, supra* note 12 at 8; Linden, *supra* note 10; Osborne, *supra* note 12 at 12 - 18; John Cooke, *supra* note 37.

[41] Justice Linden lends credence to their importance over and above all others when he comments that the "other functions of tort law are more difficult to analyze because they cannot be quantified." See Linden, *supra* note 10 at 30.

[42] Goldberg, *supra* note 37 at 525.

[43] Note that notwithstanding the seemingly conflicting arguments on whether one goal is more important than the other, this work will not attempt to combat this issue but will rather operate on the assumption that both are essential to the tort system.

It may be argued that imposition of liability on directors advances the deterrent function of tort law. In other words, the director who perpetrates a wrong should be liable so as to deter future recurrence either from him or from other directors who may think it a proper course to chart.

However with the advent of liability insurance comes the concern whether holding directors personally liable actually goes to further tort law's deterrence goal. Put another way, liability insurance is capable of removing the potency of tort law as a deterrent.[44] This is because a director tortfeasor who knows that an insurance cover is available to him in the event of liability may not take necessary care in avoiding the commission of a tort. Insurance not only cushions the effect of tortious liability but at times entirely eradicates it thereby weakening the deterring force of tort law.[45] Furthermore, the burden of liability is actually borne by the corporation which insures its directors against possible risk. It is also frequently borne by the society which pays an increased price of goods so that the corporation can recoup this cost. In this way, the more general argument against the deterrence goal of tort law - namely the availability of insurance - resonates in the particular circumstance of directors' liability.

One may argue that insurance claims by a director will lead to an increased premium and that this will prevent further recurrence. But the fact still remains that directors do not typically experience the direct impact of any

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[44] Linden, *supra* note 10 at 9, Klar, *supra* note 11 at 15 and Williams, *supra* note 15 at 165.

[45] However, increase in insurance premium, insufficiency of insurance cover, insurers' refusal to insure may have a counteractive effect which in a turnabout way instills fear of liability in tortfeasors. See Klar, *ibid.* See also Robert Stevens, *Torts and Rights* (Oxford: Oxford University Press, 2007) at 322, where he opined that notwithstanding the possibility of increase in premiums, the existence of liability insurance still reduces the effect of tort law as deterrence.

increase and will therefore not feel compelled to avoid the tortious conduct in the future. If correct, this defeats the deterrent function of tort law. However, if the conduct complained of falls within an exclusion under the policy (such as the commission of a crime), the deterrent function survives albeit in a relatively smaller number of cases.

Another argument in support of the deterrent effect of directors' personal liability is that the insurance coverage may not always be sufficient to offset the tort claim entirely. Thus the director may still end up paying part of it out of her pocket. But it appears that corporations can indemnify their directors for judgment debt accruing as a result of the performance of their directorial duties provided it accords with the *Canada Business Corporations Act* or the equivalent provincial corporate statute and corporate by-laws.[46]

For advocates of compensation as the focal point of tort law, there is little concern as to whether it is the corporation or the director who bears the cost of paying damages. Rather, the aim is to compensate the injured party. Provided the victim is paid out on her judgment, this goal of tort law is met. However, since the solvency of a corporation can never be taken for granted, the prudent director would avoid tortious conduct for fear of being caught short, even if insurance were in place. The prudent tort victim would also be wise to further protect herself by bringing an action against the corporate director as well. This does not however guarantee that she will be able to recoup an amount

[46] CBCA, s. 124; ABCA, s. 124.

equivalent to her loss as the director may be "a man of straw"[47] with little or no financial means.

The point is that the utility of imposing personal liability on directors or not simply cannot be resolved through consideration of tort functions alone. Such a sole reliance will fail based on general circumstances that can be anticipated as well as the individual case. It therefore becomes imperative to look beyond tort goals and rules for a resolution of directors' personal liability.

2.2.4 Conclusion

This section has not set out to join in the debate over the most important function of tort law. Rather the above exercise is intended to show that if achieving central tort goals are what we set out to do, then directors' personal liability may not always be the best medium for achieving it. Furthermore imposition of liability cannot be justifiably hinged on the need to ensure the furtherance of tort functions alone since there is also a corporate law context and values to consider. This forms the basis for the next section.

2.3 Corporate Law

2.3.1 Introduction

The preceding part has considered the functions and purposes of tort law with a view to determining whether it is advanced by directors personal liability or not. The same exercise will be attempted with respect to corporate law. What is the purpose of corporate law? Why do we have this body of rules and what

[47] Williams, *supra* note 15 at 165.

does it seek to achieve? Will a regime of rules holding directors personally liable for torts committed in the course of their duties to the corporation be fatal to the corporate goal?

2.3.2 Corporate Law Goals Re-examined

Unlike tort law, corporate law is not besieged by numerous functions or goals. According to Kevin McGuinness, "the fundamental objective of corporate law is to create or provide for the creation of juristic persons."[48] Corporate law as a body of rules was promulgated to encourage people to invest in, commence, maintain and expand business corporations for the purpose of making profit.[49] It does this by facilitating a business vehicle, known as business corporations, through which people can pool funds for the purpose of maximizing profits while at the same time reducing the attendant risks to the barest minimum.

According to Christopher Nicholls, the business corporation may itself have two goals – the ultimate and the profit-making objective.[50] In his opinion, the ultimate goal of the business corporation is inundated with debate.[51] He explains that the shareholders primacy group generally sees the ultimate goal of corporation as enriching the corporate shareholders. In other words, the focus for them requires ensuring the maximization of shareholders' welfare. However,

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[48] Kevin P. McGuinness, *Canadian Business Corporations Law*, 2nd ed. (Markham: LexisNexis Canada, 2007) at 286.

[49] Roberto Romano, *The Genius of American Corporate Law* (Washington: The AEI Press, 1993) at 2. According to Romano, "Corporate Law presumes that firms should be managed for shareholders', and not managers', interests when those interests conflict. Profit maximization (in a world where cash flows are uncertain, this is equivalent to maximizing equity share prices) is the goal." See also Nicholls, *supra* note 8 at 59.

[50] Nicholls, *ibid.* at 60.

[51] Nicholls, *ibid.* at 274–285. Here, Nicholls sets out the ongoing debate on the proper purpose corporations aim to serve.

as he notes, the stakeholder constituency group opine that the profits made by corporations are to be disbursed to enhance the societal life, thereby requiring that the corporate interest should encompass groups other than shareholders.[52] This implies that non-shareholder group interests deserve recognition even where such a course is detrimental to shareholders' interests.[53] For Nicholls, however, the means for achieving this ultimate goal is the profit-making objective which is generally agreeable to all commentators.[54] The only question which envelopes corporate law and a business corporation is for whom the profit is to be made. In other words, the profit making objective of business corporations is employed to either "maximize shareholder value...maximize enterprise value or...optimize shareholder value in light of the competing need to recognize the interests of other non-shareholder stakeholders or constituents."[55]

In order to effectively carry out its goals, corporate law has developed a number of distinct features. For example, business corporations are clothed with a separate legal identity, known as corporate personality, which is distinct from that of its members, directors, officers, employees and agents. On a related front,

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[52] *Ibid.* at 279. Nicholls cites the Supreme Court's decision in *Peoples Department Stores Inc. v. Wise* [2004] S.C.R. 461 at para. 46 [*Peoples*] where the court endorsed the following words of Berger J. in *Teck Corporation Limited v. Millar* [1973] 2 WWR 385 para. 96 (BCSC):

> A classical theory that once was unchallengeable must yield to the facts of modern life, In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered *bona fide* the interests of the shareholders.

[53] Nicholls, *ibid.* at 275.
[54] *Ibid.* at 61.
[55] *Ibid.* at 60.

investor liability is limited to the amount paid for their shares and no more. In other words, the shareholders are not obligated to shoulder the debts and obligations of the business corporation. Further, business corporations carry perpetual existence such that the corporate entity may carry on its business indefinitely subject to winding up or dissolution. Another important aspect of business corporations is that they are often run by a centralized management in the form of the board of directors. Perpetual existence is less critical for the purpose of this theoretical examination as it does not directly play a significant role in director's liability.

Three important features of the business corporation come to the fore when we consider the issue of corporate directors' personal liability. These are corporate personality, limited liability and the centralized management of the corporation.

2.3.2.1 Corporate Personality

As a juristic person created by law, corporations are empowered to acquire property, rights, obligations and liabilities separate and distinct from those held by their members and managers. This identifies it as legally distinct from its shareholders, directors and officers.[56] Corporate personality is thereby an important feature of the corporation as it assists the business corporation in achieving its purpose of making profit.[57] According to Mervyn Wood,

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[56] P.L. Davies, ed., *Gower's Principles of Modern Company Law,* 7th ed. (London: Sweet and Maxwell, 2003) at 27; see also Bruce Welling, *Corporate Law in Canada: The Governing Principles,* 3rd ed. (Queensland: Scribblers Publishing, 2006) at 147 – 148 [*Corporate Law*].
[57] Nicholls, *supra* note 8 at 3.

separating the corporation from its subscribers and those who run it is important because "legal certainty and business necessity require it."[58]

The concept of separate legal personality or corporate personality is traceable to the words of Lord Herschell in *Salomon* that an incorporated company should be regarded as "*ex hypothesi* a distinct legal *persona*."[59] It is often said that the concept of separate legal personality of the corporation was needed so that individuals could make and control their investments while at the same time protect themselves from the possible liabilities attendant with such a corporate form.[60] Separate personality guarantees the business corporation's ability to enter into obligations, acquire property, real or personal, and to sue and be sued for its actions.[61]

As Professor Ziegel comments that "the creation of a separate legal personality for corporations, for all its obvious economic advantages, permits a separation of the legally responsible entity from the individuals who formulate its policies."[62] The result of this concept is that it draws a line between its actions as a distinct entity and those of the people who run it. Concomitantly, the law recognizes that "every action that this distinct artificial person performs [is] carried into effect by natural persons – that is, by human beings."[63]

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[58] Mervyn Woods, "Lifting the Corporate Veil in Canada" (1957) 35 Can. Bar Rev. 1176 at 1193.
[59] *Salomon, supra* note 6 at 31.
[60] Woods, *supra* note 58 at 1178.
[61] David Goddard, "Corporate Personality – Limited Recourse and its Limits" in Grantham and Rickett, *supra* note 4 at 11. See also McGuinness, *supra* note 48 at 287.
[62] Jacob S. Ziegel, *Studies in Canadian Company Law* (Toronto: Butterworths, 1967) 657.
[63] Nicholls, *supra* note 8 at 62.

2.3.2.2 Limited Liability

According to David Stevens, limited liability is the most central feature of the modern corporation.[64] This concept has been linked to the idea of corporate personality in that they have been described as two sides of the same coin.[65] In its simplest form, limited liability in the Canadian context implies that although the liability of the investors for the corporate debt and obligations is not extinguished, it is nevertheless reduced to whatever is the sum total of her investment and nothing more. She only loses what she has invested in the company and is not required to make additional contribution. Commenting on the concept in the light of Canadian corporate jurisprudence, Ruth Kuras states that, "the reason for the creation of limited personal liability of shareholders was to attract venture capital for speculative enterprises."[66]

However, commentators and courts alike have sometimes misconceived the purpose of the concept. For example, David Stevens wrongly observes that "[Limited liability] means that the corporate patrimony is legally obliged to answer for obligations incurred by others, and that other apparent candidates for the liability, such as shareholders, *directors, and employees* are not liable."[67]

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[64] David Stevens, "The Regulation of Takeovers and the Idea of the Corporation" (1994/95) Meredith Lectures 371 at 420.
[65] Nicholls *supra* note 8 at 74. McGuiness also describes limited liability as "the most widely recognized feature of the separate existence of a corporation." See McGuinness, *supra* note 48 at 42.
[66] Ruth Kuras, "Review of Harry Glasbeek's Wealth by Stealth: Corporate Crime, Corporate Law and the Perversion of Democracy" in *Windsor Year Book of Access to Justice* (Toronto: Line Publishers, 2002) at 399.
[67] Stevens, *supra* note 64 at 420.

(emphasis added) As noted by several commentators[68] it is not the liability of the directors that is limited but that of the shareholders. According to McGuinness:

> Limited liability conferred in respect of the corporation's debts, obligations and liabilities upon the shareholders (or members) of a corporation exist only in their capacity as such. It may be lost where a shareholder acts in some other capacity, as for instance if the shareholder is a director or officer of the corporation and breaches some duty owed to it, or commits some wrong on the corporation's behalf.[69]

The misconception regarding the scope of limited liability has created a situation where it is being used to argue both for and against the imposition of liability on directors.[70] Though the view that limited liability is intended to serve the shareholders alone may appear somewhat technical, it is also historically correct. At least to this degree, directors ought not to use the limited liability shield to escape liability. However the same may not be easily concluded with respect to the flip side of the coin earlier discussed – separate personality.[71]

2.3.2.3 Centralized Management

A business corporation achieves its profit-making goal through the day to day management carried out by its directors.[72] These directors are elected by

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[68] McGuinness, *supra* note 48 at 46. See also Helen Anderson "Creditors' Rights of Recovery: Economic Theory, Corporate Jurisprudence and the Role of Fairness" (2006) Vol. 30 Melbourne U.L. Rev. 1 at 14.
[69] McGuinness, *ibid* at 46.
[70] Anderson, *supra* note 68 at 14.
[71] As aptly put by Master Funduk in *Jim Pattison Developments Ltd. v. Fudex International Inc.*[1996], 191 A.R. 282 at 285 para. 9 (M): "The existence of a corporation as a legal entity separate from its shareholders, directors, officers, and employees has for a long time taxed the ingenuity of lawyers in fastening a liability on the individuals for what would, at first sight, be a liability of the corporation."
[72] CBCA, s. 102(1).

shareholders to form the board of directors. Notwithstanding that shareholders are the ones who pull funds together for the purpose of creating the business entity, they have no direct power over the management or supervision of its workings.[73] They therefore employ the services of the board of directors. This centralized management structure has been described as a significant feature of the corporation.[74] The considerable power wielded by directors and the fact that they could otherwise afford to act without recourse to shareholders is reflected in the obligation, *inter alia,* to carry out their functions in the best interests of the corporation.[75]

2.3.3 Personal Liability and the Goal and Features of Business Corporations

The question of whether to hold directors liable for torts committed by them in the course of their duty to the corporation is submerged in the unresolved question of what constitutes a duty to act in the best interests of the corporation. If one agrees that the business corporation sets out to make profit for its shareholders, then the people who run it are expected to maximize shareholder value, notwithstanding the competing interests of other corporate stakeholders.[76] Directors' personal liability may be adverse to achieving this goal. However, if we consider the ultimate goal of the corporation to be over and above increasing shareholders' funds and to more socially responsible goals, one

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[73] McGuinness, *supra* note 48 at 93.
[74] Nicholls, *supra* note 8 at 87.
[75] CBCA, s. 122(1).
[76] Nicholls, *supra* note 8 at 60.

may be willing to look beyond profit making alone to ensuring that business corporations and those who run them work towards a degree of social servitude.

In Bruce Welling's view, when directors act in the best interest of the corporation, this should exculpate them from personal liability.[77] This, he states, is because "d]irectors ... under statutes like the CBCA act under statutory compulsion."[78] Using the case of a police officer who commits a tort in the course of carrying out his duties as an officer, he explains that, likewise, so should directors be accorded protection for committing such torts.[79] That is, holding directors personally liable for corporate torts committed in the course of their duties to the business corporation should be dependent on whether what they have done was targeted at ensuring that the best interest of the corporation is served. Acts in the interest of the corporation should be subsumed under "the general proposition that an act justified by obligation is not a tortious act." [80]

In further support of a non-liability regime, Ross Grantham and Charles Rickett have opined that corporations law deserves to be accorded primacy over torts law.[81] In their view the essence of corporations law is to promote a

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[77] See Welling, *Corporate Law, supra* note 56 at 8 and Bruce Welling, "Individual Liability for Corporate Acts" (2000) 12 Sup. Ct. L. Rev. (2d) 55 at 65-66 and 68 [Individual Liability].

[78] Welling, "Individual Liability", *ibid.* at 85. See however, David Debenham, *Executive Liability and the Law* (Toronto: Thomson Carswell, 2006) at 5. Here, Debenham in opposing the views of Welling stated that such exoneration based on statutory obligation amounts to "a mechanical application of the hoary adage that statutes take precedence over the common law where the two conflict" with no policy-based support.

[79] Welling, *Corporate Law, supra* note 56 at 147.

[80] *Ibid.* at 148-149.

[81] Grantham & Rickett, "Directors' Tortious Liability" *supra* note 7 at 139; See also Ross Grantham "The Limited Liability of Company Directors", *supra* note 7 at 365 where Prof. Grantham while responding to an argument in support of holding directors liable for their own torts stated as follows:

> One of the principal arguments in favour of holding directors liable for their own torts is that to do otherwise would be to frustrate the aims and objectives

situation where laws that will ordinarily have been applicable to one individual are now diverted to another (the corporation). In essence the corporation takes up a human form for the purpose of application of corporations law. They also argue that to support a legal regime that holds directors liable for actions carried out in the course of their duties will be to destroy the theoretical basis upon which corporations law is built.[82]

In addition, it can also be argued that the distinct nature of the business corporation and its inability to act other than through its directors implies that whatever actions are taken on its behalf should be attributed to the corporation itself and not the people who run it.[83] This leads us to a conclusion that exonerates directors from liability in order to ensure that the business vehicle achieves its goal of profit maximization.

Conversely, imposition of liability on directors might create a situation where the directors are risk averse and this works to the detriment of the shareholder wealth maximization objective.[84] In other words, personal responsibility for torts committed in the course of directorial duties will run counter to attaining the corporate goal because it breaks down corporate walls to attach to the persons behind the day-to-day running of the business enterprise.

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of tort law. However, this "frustration" may be one of the very purposes of company law.

[82] Grantham & Rickett, *ibid.* The authors state that "to refuse to accept that these general principles [of tort law] are modified is not only to deny the primacy inherent in the rules of company law, but in a sense it is to deny the company's very existence".

[83] *ScotiaMcleod Inc. v. Peoples Jewellers* (1995) 26 O.R. (3d) 481, 129 D.L.R. (4th) 711 at 720 (C.A.) [*ScotiaMcleod*]. See also *Blacklaws v. 470433 Alberta Ltd.* [2000] 187 D.L.R. (4th) 614 at para. 126 (Alta. C.A.) per Berger J.A. [*Blacklaws*].

[84] Anderson, *supra* note 68 at 27.

2.3.4 Conclusion

As much as the classic features of a corporation are important for the business corporation to achieve its objective, one cannot solely rely on them for justifying non-liability of corporate directors. Notwithstanding that the features of the corporation and its objective lend credence to arguing for non-liability, it puts tort claimants at an unfair disadvantage. For example, they may not be able to claim from the corporation because it is financially distressed and they cannot claim from shareholders because of the principles of limited liability. In the light of tort goals, it would be unfair to automatically shut them out of the only other alternative for compensation – directors' personal liability. Beyond this, a flat prohibition against directors' liability would tremendously undermine the deterrence function of tort discussed earlier.

It therefore becomes imperative that any rule of law regarding directors' third party liability acknowledges the sometimes competing goals of tort law and corporate law. The difficulty lies in striking the proper balance between ensuring respect for the tort objectives of compensation and deterrence on the one hand, and the promotion of profit maximization goal of the corporation, on the other. How then does the law best achieve these objectives while at the same time ensure that justice is served?

2.4 Efficiency or Fairness – Yardstick for Measurement

2.4.1 Introduction

The specific issue of directors' liability in tort to the corporation's creditors is a small part of an ongoing debate on extending further protection to creditors through imposition of additional duties on directors. This aspect of the debate is particularly germane to the issues highlighted thus far because tort victims are in the wide pool of people generally referred to as company creditors.[85] While there are many schools of thought, the question regarding liability to tort creditors has been most systematically considered by two major movements – the law and economics movement and the progressive movement. Whilst the law and economics school looks to ensuring that efficiency is the watchword for legal rules, progressives opine that fairness and justice must trump efficiency values. The next two subsections examine the position of the two schools with the objective of determining their relevance to resolving liability questions.

2.4.2 The Law and Economics Movement and the Value of Efficiency

It has been stated that economic analysis of law "ties together diverse areas of law, providing a common theoretical structure".[86] From an economic standpoint, laws seek to "maximize economic efficiency and to encourage

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[85] Andrew Keay, "Formulating a Framework for Directors' Duties to Creditors: An Entity Maximization Approach" (2005) 64(3) Cambridge L.J. 614 at 629.

[86] David D. Friedman, *Economic Analysis of Law Lecture Notes* (Faculty of Law, Santa Clara Law School, 1995),online:<http://www.daviddfriedman.com/Law_and_Econ_97/L_and_E_97_LS_Outline.html#RTFToC5> (accessed August 11, 2008). This assertion is debatable.

activity which generates a surplus of economic gains over economic costs".[87] In fact, efficiency has been described as "the bedrock of gold that has carried economic analysis of law through three decades now".[88] For a legal rule to be considered as an efficient rule, its aggregate benefit must exceed its aggregate costs.[89] In view of this, economists perceive liability to be required only where it will bring about greater economic benefit than a refusal to impose liability.[90]

Economists generally see the goal of corporations as one requiring the directors to maximize the value of the business corporation for the benefit of the investors.[91] An important way to accomplishing this is to give directors corporate freedom while also reducing the transaction costs of running the business. In view of the efficiency-prone target of the economists, directors' personal liability would be acceptable only if it would not increase the transaction costs of running the corporation.[92]

The major argument that has been advanced in favour of non-liability of directors to tort creditors is that it will restrict risk taking on the part of the directors thereby causing a reduction in the profit accruing to shareholders. Self-preservation will take precedence over corporate interest. In other words, a director's personal liability regime will stifle the company's development as

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[87] Peter Cane, *Tort Law and Economic Interests* (Oxford: Clarendon Press, 1996) at 473.
[88] Gillian Hadfield, "The Second Wave of Law and Economics: Learning to Surf" in M. Richardson and G. Hadfield (ed.) *The Second Wave on Law and Economics,* (Sydney: Federation Press, 1999) at 56.
[89] Polinsky A. M., *An Introduction to Law and Economics* (Boston: Little Brown & Co., 1989) at 7 cited by Andrew Keay, *Company Directors' Responsibilities to Creditors* (London: Routledge Cavendish, 2007) at 297.
[90] Cane, *supra* note 87 at 472.
[91] B. Black and R. Kraackman, "A Self-enforcing Model of Corporate Law" (1996) 109 Harv. L. Rev. 1911 at 1921.
[92] Keay, *supra* note 89 at 296.

directors will be more interested in securing their positions rather than increasing the company's value.[93] Few business decisions would be made and directors may even refrain from dealing with third parties all in the name of avoiding committing torts against them. Also the undue economic hardship arising from directors' personal liability becomes pronounced in relation to one person corporations.[94]

One way to reduce risk averseness is probably for the corporation itself to either insure its directors or provide indemnity for any loss incurred by them in the course of fulfilling their corporate duties. From an economic perspective of corporate law, this may be viewed as additional costs to be borne by the company and invariably by the shareholders. In other words imposition of liability on directors will increase transaction costs and thereby prevent resources being used by the corporation in the most economically efficient way.[95]

Economists consider tort law like every other area of law, to concern itself with what will be most efficient. Richard Posner, a forerunner of the law and economics approach to tort law, argues that tort principles should aim at attaining the goals of economic efficiency, which allow for the proper allocation

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[93] Keay, *ibid.* at 311-312.

[94] The hard effect of holding directors responsible for all corporate actions is more obvious in one-man corporations where the sole shareholder is usually the sole director of the corporation. In such a context there would be little rationale to incorporation from a liability perspective.

[95] Anderson, *supra* note 68 at 7. Anderson made this comment while referring to Ronald Coase, 'The Problem of Social Cost" (1960) 3 J. L. & Econ. 1. Stephen Bainbridge describes transaction costs as "the economic equivalent of friction-dead weight losses that increase the cost of transacting and, hence, reduce the number of transactions." See Stephen M Bainbridge *Corporation Law and Economics* (New York: Foundation Press, 2002) at 33.

of resources in the society.[96] The focus then is maximizing aggregate social welfare as measured from an economic perspective. The difficulty that may arise from this is measuring the benefit of a director's tortious action to the society in the long run. An individual tort victim will not, however, envision the overall advantage the tort will eventually bring to the society. All she is concerned about is compensation for the immediate loss suffered.

A related focus of tort law is to reduce risky behaviour to an economically and socially optimal minimum.[97] The unresolved question then is a battle between encouraging risk taking so as to achieve corporate goals while reducing risky behavior so as to enforce tort goals. Perhaps because this question has been described as the "Achilles' heel of the law and economics school"[98] its members have provided no justifiable answer.[99] It has been observed that Richard Posner gives no solution to the issue[100] while Easterbrook and Fischel only parry the issue.[101] Indeed another commentator, Anderson, (who opposes an economic approach to directors personal liability), states that a law and economic approach will require that one determine:

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[96] See discussion by Stephen D. Sugarman, "The "Necessity" Defense And the Failure of Tort Theory: The Case Against Strict Liability for Damages Caused While Exercising Self-Help In An Emergency" in *Issues in Legal Scholarship, Vincent v. Lake Erie Transportation Co. and the Doctrine of Necessity* (2005) Article 1 http://www.bepress.com/cgi/viewcontent.cgi?article=1063&context=ils.

[97] Francis Trinidade *et al, The Law of Torts in Australia,* 4th ed. (Australia: Oxford University Press, 2007) at 25.

[98] Keay, *supra* note 89 at 332. Although Keay referred to involuntary and some voluntary creditors, the same can be applied to tort creditors because they fall into this group.

[99] Keay, *ibid.*

[100] See Keay, *ibid.*

[101] Keay, *ibid.* See also Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1996) 52-54. According to Easterbrook and Fischel, corporate directors will ensure that adequate insurance is provided to cover eventualities of tort claimants to avoid a situation which is likely to affect the financial status of the corporation; see also Keay, *ibid.*

> whether the net benefit to the company ...from a situation of 'no director liability' exceeds the net harm that this causes to the creditors ... [or] the question could be phrased as being whether the net benefit to the creditors from a situation of having director liability exceeds the net harm that this causes to the company through its adverse effect on director behavior and demand for compensation.[102]

The answer to this, claims Anderson, is difficult to provide with confidence.[103] From the above it is clear that employing an economic approach is only somewhat helpful and raises considerable concerns.

2.4.3 The Progressives Movement and the Value of Fairness

The term fairness is challenging to define[104] and this has been attributed to its intuitive nature as opposed to empiricism infusing law and economics.[105] The complicated nature of substantive fairness and the problem accompanying its characterization has influenced some advocates[106] to rely on definitions of procedural fairness. For example, Lawrence E. Mitchell defines procedural fairness as follows:

> Fairness, as described by and as used throughout our legal system, is a concept of balance, of proportionality among the parties to a transaction or proceeding. It is a concept that largely has developed in connection with questions of the justice of contractual or procedural arrangements.[107]

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[102] Anderson, *supra* note 68 at 12.
[103] *Ibid.* Although the comments were made in respect of directors' liability to creditors on a general level, the same can be applied to directors' personal liability to tort creditors.
[104] Lawrence E. Mitchell, "Fairness and Trust in Corporate Law" (1993) 43 Duke L.J. 425 at 451. See also Keay, *supra* note 89 at 305 and Anderson, *ibid.* at 3.
[105] Keay, *ibid.*
[106] Anderson, *supra* note 68 at 1. See also Keay, *ibid* at 305.
[107] Mitchell, *supra* note 104 at 426. It should be noted, however, that despite Mitchell's great insight into the concept of fairness, his definition only explains the concept of procedural fairness rather than substantive fairness. It may therefore not be fully relied on for understanding substantive fairness.

Others regard the matter of fairness more substantively. Michael Swygert and Katherine Earle Yanes, for example, state that fairness focuses on using "the law for redressing and adjusting inequalities of both the opportunities for seeking society's scarce resources and the resulting allocation of those resources".[108] The issue of fairness as it relates to tort creditors may arise due to the vulnerable position held by these claimants when injured by an insolvent corporation through the agency of a director. The growing recognition of "non-shareholders stakeholders in corporate law"[109] makes directors' personal liability issues an important facet of the fairness debate.

The Progressives argue that it is only "fair" that a director who personally commits a tort while carrying out his duties to the corporation be held liable for the consequences of his wrongful actions, just like every other individual tortfeasor will.[110] This ensures that vulnerable tort victims who have not signed on for the harm done to them are duly protected. According to Helen Anderson, since agents of non-corporate legal entities are usually personally liable even in the face of the principal's vicarious liability, there is no reason why directors should be treated differently.[111]

Commentators in support of fairness further state that imposition of liability on directors serves as a major deterrence of improper behavior *ex ante* and where a director still goes ahead to carry out the antisocial conduct then it

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[108] Michael Swygert and Katherine Earle Yanes, "A Unified Theory of Justice: The Integration of Fairness into Efficiency" (1998) 73 Wash. L. Rev. 249 at 288.
[109] Anderson, *supra* note 68 at 4.
[110] *Ibid.* at 23.
[111] *Ibid.*

will attach to him in the form of personal liability *ex post.*[112] As well, injured persons are compensated for their losses.[113]

However, the Law and Economics school may argue that while the use of the doctrine of fairness makes tort creditors better off by imposing liability on directors, it also makes directors, who are usually not recipients of the profit *qua* directors, worse off.[114] This in itself creates an unfair state for the directors who do not directly receive the proceeds derived from the commission of the tort but have only done so to increase the company's profit. As much as fairness can be used as a yardstick for sifting through a case in which a director will be held liable for torts committed while acting on behalf of the corporation, many fairness advocates realize the difficulty in a coherent and consistent fairness test. This may be why they have stated that they do not argue that fairness be used as a determinant of the rights of a tort claimant against company directors.[115] Rather they claim that courts should put it into consideration on a balance of proportionality basis.[116] In other words, the determination of *when* it will be fair to hold directors personally liable to tort creditors is still one left for the court to decide, with fairness being only one of the important factors in the mix.

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[112] *Ibid.* at 22.
[113] Goldberg, *supra* note 37 at 525.
[114] Keay, *supra* note 89 at 308. Note however that Keay countered this position by stating that tort [unsecured] creditors are not enjoying any special benefit but are only obtaining what is legally due to them.
[115] Anderson, *supra* note 68 at 4.
[116] Mitchell, *supra* note 104; Keay, *supra* note 89; and Anderson, *ibid* at 4.

2.4.4 Conclusion

The preceding sections reveal the inadequacy of these two main approaches to liability. The next part suggests a middle course triggered by the extent of a given director's culpability.

2.5 Culpability-based Personal Liability

2.5.1 Introduction

In order to reach a common ground between upholding the goal of corporate law and the functions of tort law, it is important to leave the ambit of both laws to find a rule that combines them judiciously. Much as clarification and assistance can be garnered from the works of those writing from law and economics perspective or progressive perspective, one needs to adopt a practical position which will ensure that efficiency as well as fairness is borne out in determining directors' liability to third party tort claimants.

This thesis advances culpability as the determining factor for imposing personal liability on directors. It will be argued that weighing the levels of culpability of a director's actions will assist in furthering the deterrence and compensatory goal of tort law while also advancing the corporate goal of wealth maximization achieved through directors acting in the best interest of the corporation. The goal is to give directors freedom to take reasonable risk while also avoiding unreasonably risky behavior. In effect, corporations will be run efficiently and tort victims will be treated fairly by calibrating directors' personal liability according to culpability.

2.5.2 Culpability

Culpability has been defined to mean "blame, blameworthiness, negligence, guilt, being at fault".[117] The term culpability as used in this thesis connotes the level of fault that can be attributed to a director before she can be held liable for a tort committed in the course of her duties to the corporation.

The system advocated here for calibrating liability in relation to culpability identifies three levels of fault, namely fault arising from an intentional tort, fault arising from gross negligence and fault arising from ordinary negligence.

2.5.2.1 Culpability and Intentional torts

The first level of fault identified by the culpability theory is tied to intentional torts. As a general proposition, directors should be liable for intentional torts for a number of reasons. First, due to the degree of intent found in intentional torts, it is very unlikely that business corporations would authorize their directors to perpetrate such classes of torts. This points to the director essentially acting of his own accord. That is, he has veered "outside the range of his powers."[118] Second, most intentional torts will not even advance the long-term profit maximization objective of corporations.[119] It therefore becomes

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[117] Daphne A. Dukelow, *The Dictionary of Canadian Law*, 3rd ed. (Toronto: Thomson Carswell, 2004).

[118] Welling, "Individual Liability", *supra* note 77 at 69.

[119] This is with the exception of inducement of breach of contract. Directors are allowed to advise their corporations to renege on an agreement where acting in the best interest of the corporation. This accommodates the notion that corporations may refrain from performing the contract when it is economically beneficial to do so. This exception is considered more extensively later in this thesis.

difficult for a director to justify an intentional tort committed by him based on a corporate duty owed to the corporation.

Third, the diverse purposes advanced by tort law create situations where one of the two major purposes is selected over the other. As explained by Professor Glanville Williams, in such circumstances there is a tendency to choose the deterrent goal of tort law as the special focus of intentional torts.[120] In effect, personal responsibility for intentional torts furthers the deterrent goal of tort law and does not in any meaningful way impinge on the corporate goal of profit maximization. The *culpa* arising from intentional torts is a high level of culpability. From a fairness and efficiency perspective, holding a director liable for his intentional torts ensures that the third party is treated justly and the corporation can still perform efficiently. The only exception is the intentional tort of inducing breach of contract. As will be discussed later in this thesis, inducing breach of contract is appropriately handled by a specialized set of rules.

2.5.2.2 Culpability and Gross Negligence

The next sub-sections will outline the culpability theory and gross and ordinary negligence. For context, however, it is expedient to first consider the tort of negligence *simpliciter*. Negligence has been described by Mr. Justice Linden as "the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not

[120] Williams, *supra* note 15 at 172.

do."[121] The tort of negligence seeks to compensate those who have suffered as a result of the unreasonable conduct of others.[122] The Supreme Court of Canada has reiterated the conditions for establishing negligence in the case of *Cooper v. Hobart*.[123] Reformulating the *Anns* test[124] for negligence, the court stated that for a case of negligence to be made out, the harm done to the plaintiff must be the reasonably foreseeable consequence of the defendant's act to which there are no policy concerns as a result of their relationship capable of barring a *prima facie* duty of care. Having confirmed the existence of a *prima facie* duty the court would further determine whether there are other residual policy concerns extraneous to the relationship between the parties which may also negate the duty of care.[125] According to Professor Lewis Klar, the effect of this reformulation of the *Anns* test may discourage the extension of negligence law, thereby limiting its coverage.[126]

In the corporate setting, the plaintiff's ability to show the existence of a duty of care owed by the defendant director may bring about liability on the part of the director. However, applying this tort principle *in vacuo* would impede justice as directors' actions are carried out on behalf of the corporation.

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[121] Linden, *supra* note 10 at 140 citing Baron Alderson in *Blyth v. Birmingham Water Works Co.* [1856] 11 Exch.781 at 784; See also *Thompson v. Fraser* [1955] S.C.R. 419 at 425 where negligence was termed "the failure to use the care a reasonable man would have exercised under the same or similar circumstances...".

[122] Klar, *supra* note 11 at 151.

[123] [2001] 3 S.C.R. 537 [*Cooper*].

[124] The *Anns* test entails inferring a duty of care upon the establishment of a relationship of proximity based on foreseeability of harm which duty can be limited by policy concerns. See Klar, *supra* note 11 at 166.

[125] *Cooper, supra* note 123 para. 30. See also Klar, *supra* note 11 at 166-167.

[126] Klar, *ibid.* at 169.

Negligence law recognizes that there will be different degrees of care determinable from the facts of each case.

This recognition is not a new innovation to legal jurisprudence. According to Professor Lewis Klar, "the concept of negligence itself is very wide, ranging from conduct which might be only slightly substandard to that which can be described as grossly negligent, or reckless."[127] He further states that actions could be seen as falling somewhere along a continuum with pure accidents at one end and deliberate misbehavior at the other and with each categorization dependent on the degree.[128] With these range of conduct bringing about liability, legislators have often seen the necessity to notify courts that defendants engaged in certain types of activities ought to be given less onerous legal burdens. [129] In other words, "because of factors peculiar to the activity, the balance ought to be tilted in the defendant's favour, making it more difficult for a victim to show that the defendant's conduct ought to result in legal liability."[130] These degrees of negligence have seen courts distinguishing between gross negligence and ordinary negligence. According to Cecil A. Wright, the law relies on this distinction wherever there is need to decrease responsibility[131] and one of such area is with respect to directors' liability.[132] Indeed, Wright specifically mentions the case of directors as one requiring distinction between gross and ordinary negligence.

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[127] *Ibid.* at 10.
[128] *Ibid.* at 10.
[129] *Ibid.* at 329.
[130] *Ibid.*
[131] Cecil Wright, "Gross Negligence" (1983) 33 U.T.L.J. 184 at 196.
[132] *Ibid.*

The second level of fault proposed is attributed to all acts of corporate directors that will amount to gross negligence. Notwithstanding the difficulty in defining gross negligence,[133] Strayer J. has described it in *Lucien Venne v. Her Majesty the Queen* as follows:

> Gross negligence must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.[134]

Gross negligence has also been defined as "a conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party, who may typically recover exemplary damages".[135] It displays acts close to intentional torts on the part of the perpetrator which separates the director tortfeasor from the corporation. In view of this proximity to intentional torts, this thesis argues that it should be treated distinctly from less culpable forms of negligence.

For the reasons given above in relation to intentional torts, directors who conduct themselves with gross negligence should also face the correction of personal liability.

2.5.2.3 Culpability and Ordinary Negligence

The third level of fault proposed recognizes other forms of directors' acts that may be termed ordinary negligence. Ordinary negligence portrays corporate

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[133] Klar, *supra* note 11 at 331.

[134] [1984] 84 D.T.C. 6247 at 6256. In this case the court held that a tax payer's negligence for failing to notice the error as computed by his bookkeeper did not amount to gross negligence. This definition was adopted by the Federal Court of Appeal in *Findlay v. Canada* [2000] F.C.J. 731.

[135] Bryan A. Garner ed., *Blacks Law Dictionary*, 7th ed. (Minnesota: West Group, 1999) at 1057.

acts falling outside the ambit of gross negligence. It has been suggested that gross negligence is a question of fact to be discovered by the trial judge and that in doing so, the court should consider the cumulative effect of all the factors that result in the casualty.[136] Any set of facts which falls short of this "very great negligence",[137] would therefore constitute ordinary negligence to which liability should not attach.

Culpability theory therefore suggests that directors should not be found liable for ordinary negligence. Inadvertent acts of a director perpetrated while carrying out her duties to the corporation lack an egregious quality. In this situation, there is usually a difficulty in drawing a line between when the director is acting on his own and when he is acting for the corporation. In other words, the act of the director may not be easily separated from that attributed to the corporation. Holding directors liable for this kind of negligence may affect directors' behavior adversely and eventually cause the corporation to suffer loss of profit due to a director's risk aversion. Even for the Progressives, attaching liability would be unpalatable since it would threaten a corporation's overall financial viability and with it, its ability to compensate third parties who have been injured by more serious circumstances.

Limiting third party's liability claims to the corporation in the case of simple negligence gives directors the freedom to take reasonable business risks without fear of liability. This limitation also advances the compensatory goal of

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[136] Linden, *supra* note 10 at 197. See also *Gordon v. Nutbean* [1969] 2 O.R. 420 (H.C.J.). Although an automobile accident case was referred to, it appears that this would be useful in also determining when directors should be liable for acts of negligence.

[137] Per Kerwin J., when describing gross negligence in *Studer v. Cowper* [1954] S.C.R. 450 at 455.

tort law because the corporation's ability to compensate tort victims who have been the recipient of more egregious faults becomes more certain because it preserves corporate assets. It also satisfies the concern of the law and economic school in that the better risk-bearer – the corporation – takes full responsibility for the wrong while also enjoying any benefit accruing to it. In this way the corporation bears the responsibility for whether or not it is efficient to carry on this less culpable form of tort action.

2.6 Conclusion

This part of the thesis has highlighted the special goals of corporate and tort law with a view to addressing the issue of directors' personal liability. Compensation and deterrence are the key functions of tort law while profit maximization is the focus of corporate law and business corporations alike. Having reached a defensible consensus on the focus of both areas, I subsequently explored two major schools of thoughts – law and economics and the progressive movement – and their treatment of directors' personal liability for corporate torts. This part identified culpability as a mediator between the approaches.

In other to measure the sustainability of the above-suggested theoretical perspective, the next part carries out an in-depth review of Canadian law regarding directors' tortious liability to third parties.

PART III DIRECTORS' PERSONAL LIABILITY – THE CANADIAN CASE LAW

3.1 Introduction

In determining third party liability, Canadian law has had difficulty in drawing a line between where a director's actions as agent end and where an action in her personal capacity begins. The competition between the basic principles of corporations law on the one hand and tort law on the other hand are aptly summarized by Justice Le Dain in the Canadian case of *Mentmore Manufacturing Co. v. National Merchandise Manufacturing Co.* as follows:

> What is involved here is a very difficult question of policy. On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. On the other hand, there is the principle that everyone should answer for his tortious acts.[138]

Where the facts of a case allege wrongful acts on the part of directors, there are usually two parties contesting for the court's favour. There is the plaintiff/third party victim against whom a wrong has been perpetrated and who seeks redress from the court. His desire is to ensure that all possible defendants are brought to account so that he will see compensation. There is also the defendant/ tortfeasor director who seeks to avoid being punished for a wrongful act committed in the course of carrying out her duties to her master, the corporation.

Faced with this scenario, Canadian courts have developed two main approaches. The first approach takes corporate law as its focus and is therefore

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[138] (1978) 89 D.L.R. (3d) 195 at 202 (F.C.A.) [*Mentmore*].

defendant driven (the Corporations Law approach) while the second approach takes tort law as its focus (the Tort Law approach) and is thereby plaintiff driven. The approaches reflect which particular area of law weighs on the mind of the court considering the facts of each case and in effect which party is more deserving of justice. And, notwithstanding considerable judicial and academic commentary on point, there is still no consensus on the approach to be adopted in Canada.

What follows is a more detailed account of each approach with special emphasis on the inconsistencies created by them. This part will also assess these two approaches in light of the theoretical perspective established in the previous part.

3.2 Corporations Law Approach

3.2.1 Analysis

The basis for the Corporations Law approach is derived from the fundamental principle of corporate personality earlier mentioned which connotes that corporations are artificial beings capable of only acting through human agents.[139] Thus, corporate acts performed by directors on behalf of the corporation are viewed as the acts of the corporation.[140] It is through this idea of

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[139] Justice Finlayson in *ScotiaMcleod, supra* note 83 at 721 observes that as corporations are "an inanimate piece of legal machinery incapable of thought or action, the court can only determine its legal liability by assessing the conduct of those who caused the company to act in the way that it did."

[140] Professors Bonham and Soberman, while describing the realists organic theory of the corporation, painted directors in these classic terms:

> [T]he most important body, the one that governs the corporation from day to day and makes the major business decisions, the board of directors, is likened

merging the acts of the directors with that of the corporation that the mind and will of the corporation is discovered. According to this school of thought, a director is thereby viewed as the "directing mind"[141] of the corporation. In fact the director as the directing mind and will of the corporation forms the basis of the identification theory used in criminal law to find corporation's criminally liable[142] as well as primary liability in tort.[143]

In addition to the fact that directors are the directing mind and will of corporations, Professor John H. Farrar's sees them as "the organ or instrument"[144] through which the corporation functions. Without the services of directors, corporations would be incapable of carrying out their business. The effect of this is that while a corporation can be held liable for contracts entered into, actions taken or statements made by its directors[145] on its behalf, "personal liability will [not] flow through the corporation to [its directors]" merely because their actions are found wanting.[146]

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to the head, the controlling organ. The actions of the board then become not merely actions of an agent but the actions of the company itself.

See David H. Bonham and Daniel A. Soberman, "The Nature of Corporate Personality" in Ziegel, *supra* note 62 at 12 [Bonham and Soberman]. See also Professor Grantham's organic approach to attributing directors actions to the corporation in Grantham, "The Limited Liability of Company Directors", *supra* note 7 at 384-385.

[141] *Lennard's Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.* [1915] A.C. 705 at 713 (H.L.) (Where the court held that the tortious actions of a director of the defendant company (a ship owner) is in fact the conduct of the company since he acted as the directing mind and will of the corporation. It is important to note however that the shipping company tried to avoid liability by contending that the action in question was not its own.) [*Lennard's*]. See also Bonham and Soberman, *ibid* at 12-13.

[142] Nicholls, *supra* note 3 at 12

[143] *ScotiaMcleod, supra* note 83 at 721.

[144] John H. Farrar, "The Personal Liability of Directors for Corporate Torts" (1997) 9 Bond Law Review 102 at 103.

[145] *Lennard's, supra* note 141.

[146] *ScotiaMcleod, supra* note 83 at 721.

Professor Christopher Nicholls has described the Ontario court of appeal's decision in *ScotiaMcCleod* as having marked "[a]n important milestone"[147] on this issue. In this part of the thesis, I will take the position that *ScotiaMcleod* manifests the Corporations Law approach because it provides the directors with broad shield of protection against tortious claims by third parties. In this case, ScotiaMcleod were underwriters in a debenture purchase transaction between Peoples Jewellers, on the one part, and Montreal Trust Company of Canada and Credit Lyonnais Canada ('the Banks'), on the other part. Due to non-disclosure of information that the Banks considered to be crucial to the transaction, the Banks instituted an action against ScotiaMcleod and its officers. ScotiaMcleod subsequently commenced a third party claim against the directors of Peoples Jewellers to protect it (ScotiaMcleod) against any adverse outcome of the Banks' suit. According to ScotiaMcleod, the directors of Peoples Jewellers had intentionally or negligently misrepresented the contingent liabilities of Peoples Jewellers which misrepresentation informed the Banks' decision to take up the debenture. Further, it was alleged that two executive directors of Peoples had made representations at various due diligence meetings that the liabilities in issue were not material to the financial affairs of Peoples. In addition, the two executive directors, together with two other directors of Peoples, signed a prospectus containing the following statements:

> The foregoing, together with the documents incorporated herein by reference, *constitutes full, true and plain disclosure of all material facts* relating to the securities offered by this short form prospectus as required by the securities laws of all of the provinces of Canada. For the purposes of the *Securities Act*

[147] Nicholls, *supra* note 3 at 9.

> (Quebec), this simplified prospectus, as supplemented by the permanent information record, contains *no misrepresentation that is likely to affect the value or the market price of the securities to be distributed.* [Emphasis mine.]

Further, the two directors were alleged to have been integrally involved in the marketing of Peoples debentures to prospective debenture holders.

Employing what appears to be the Corporations Law approach, the court stated that directors (officers and employees) acting *bona fide* in the course of their duties to the corporation cannot be held liable for tortious actions carried out by them except in specific circumstances. According to the court:

> The decided cases in which employees and officers of companies have been found personally liable for actions ostensibly carried out under a corporate name are fact-specific. In the absence of findings of fraud, deceit, dishonesty or want of authority on the part of employees or officers, they are also rare.
>
> Absent allegations which fit within the categories described above, officers or employees of limited companies are protected from personal liability unless it can be shown that their actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own.[148]

Invariably, it is only in the above situations that directors should be taken "out of the role of directing minds of the corporation"[149] and stripped of protection from personal liability. The effect of this position is that all a director needs to avoid personal liability is to act within the scope of her duty and in the best interests of the corporation.[150]

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[148] *ScotiaMcleod, supra* note 83 at 720.
[149] *ScotiaMcleod, ibid.* See also *Blacklaws, supra* note 83.
[150] See Edward M. Iacobucci, "Unfinished Business: An Analysis of Stones Unturned in *Adga International v. Valcom Ltd.*" [2001] 35 Can. Bus. L. J. 39 at 41.

The decision in *ScotiaMcleod* has been followed by a number of later decisions[151] notable among which is *Normart Management Limited v. Westhill Redevelopment Company*[152] where the directors of the defendant corporations were alleged to have conspired to injure the plaintiff by depriving it of its interest in Bond Lake Property, the object of a mortgage sale set up by the defendants. The court, in a unanimous decision, stated that it would only hold the directors personally liable for conspiracy to injure if the pleadings suggest that the directors of the corporations acted outside the scope of their authority and were no longer directing mind of the corporations. [153]

Based on the above, it appears that where the acts leading to a tort are intended to benefit the corporation, only the corporation will be held liable in tort. Not even the fact that the defendant director made personal gain will invite liability on him.[154] The cloak of "directing mind" is a complete defence.

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[151] *Blacklaws, supra* note 83. In this case, the court of appeal, while quoting *ScotiaMcleod* with approval, held that the manager/owner of a corporation was not liable for negligence as no duty of care existed. Note also the dissenting judgment of Justice Berger where he held that the owner should be liable based on the decision in *Adga. Leon Van Neck and Son Ltd. v. Mcgorman* [1998] O.J. No. 4813 para. 133 (Ont. Ct. J. (Gen. Div.)) [*Leon Van Neck*]. (The court relied on *ScotiaMcleod* in relieving certain directors of the defendant corporation from liability for negligent misrepresentation purportedly caused by their silence on the ground that no fraud, deceit or independent tort had been committed by them.); *Schmidt v. Bell Canada* [1999] O.J. No. 3176 para. 10 (Ont. Sup. Ct.). (The court relied on *ScotiaMcleod* and *Normart Management, infra* note 152, to hold that a director was not liable because his actions, though specifically pleaded, were not separate from that of the corporate defendant); *Rafiki Properties Ltd. v. Integrated Housing Development Ltd* [1999] B.C.J. No. 243 (B.C.S.C.). (The court held, among other matters, that the negligence claim against the directors of the defendant company made no suggestion of an identity or interest apart from that of the company, which made the actions of the principals their own.)

[152] [1998] 37 O.R. (3d) 97, 155 D.L.R. (4th) 627 (C.A.) [*Normart*].

[153] *Normart, ibid.* para 22. See also Nicholls, *supra* note 3 at 14

[154] *Normart, ibid.* at 633 wherein the court states "[L]iability does not attach to the individual [directors] merely by virtue of the fact that the individual [directors] stood to gain from the completion of the impugned transaction as a result of their financial positions within the respondent corporations".

Directors of two separate corporations can also agree on behalf of their corporations to take steps which may subsequently result in the commission of a tort against a third party. According to Justice Finlayson in *Normart*, such agreements "can amount to the tort of conspiracy, but it does not necessarily follow that those who as directing minds caused their respective corporations to enter into the agreement are themselves party to the conspiracy".[155] Rather, the directing minds were acting on behalf of their corporations and to hold them personally liable for an agreement entered into within the scope of their authority and in the best interest of their corporations "would be to challenge the recognized separate legal identity afforded to corporations ...".[156]

In this way, *ScotiaMcleod* prefers a dispensation where directors are generally protected from personal liability unless it can be shown that their actions were themselves tortious or exhibit an identity that is separate from that of the corporation so as to make the action their own.[157] This position is confirmed by the fact that Justice Finlayson, who gave the lead judgment in *ScotiaMcleod,* subsequently reiterated this position in his lead judgment in *Normart.*[158] In addition, it is significant that the court was willing to employ the identification theory developed for imposing liability on corporations as a ground for relieving directors of personal liability.

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[155] *Ibid.* at 634. The two corporations and not their directors may be liable for conspiracy. See *1175777 Ontario Ltd. v. Magna International Inc.* [2001] O.J. No. 1621, 200 D.L.R. (4th) 521 (C.A). In this case, the court allowed an allegation of conspiracy between the director of a parent company and the subsidiary company to injure a third party, to go to trial.
[156] *Normart, ibid.*
[157] *ScotiaMcleod, supra* note 83 at 720.
[158] *Normart, supra* note 152 at 633.

Decisions like *ScotiaMcleod* and *Normart* showcase the Corporations Law approach upholding the corporate personality of the corporation while only leaving a small window of liability on the director. This window of liability recognizes the policy ground of tort law in extreme cases where the actions are "themselves tortious or exhibit a separate identity or interest from that of the company".

Notwithstanding the development of this area of law as canvassed by *ScotiaMcleod,* the status of *ScotiaMcleod* remains embedded in controversy due to the subsequent decision of the Ontario court of appeal in *Adga.*[159] This is because *Adga,* and certain subsequent cases following it, have purportedly relied on *ScotiaMcleod* in support of holding directors liable for torts committed in the course of pursuing their duties as directing minds of a corporation. In other words, notwithstanding *ScotiaMcleod's* reluctance to hold directors personally liable and the exceedingly narrow ground it articulates for doing so, *Adga* moves in the exact opposite direction. Ironically and confusingly, *Adga* relies on *ScotiaMcleod* to chart a course for a broad view of director's liability. Section 3.3.1 of this thesis provides a more detailed account of *Adga.*

3.2.2 Scholarly Reaction to the Corporations Law Approach

While containing a laudable objective, there are a number of grounds upon which the Corporations Law approach is vulnerable to criticism. First, its entire reasoning is premised on largely one goal – to respect the principle of

[159] Nicholls, *supra* note 3 at 37. A detailed review of this case will be considered later. See also *Schmidt, supra* note 151, decided after *Adga* but taking a *ScotiaMcleod* approach.

separate legal existence by shielding defendant directors from personal liability through an extension of the corporate veil to them. It therefore takes us back to where we started from; it enables corporate directors to use their position to perpetrate civil wrongs while hiding behind the cloak of the corporation. Courts are then required to lift the veil of incorporation in order to reach the officers behind the curtain.[160] Mervyn Woods has commented that he is not surprised that "the veil [of incorporation is] lifted somewhat to help distinguish those situations in which the director acts for the company from those in which he will be looked upon as acting for himself."[161] The corporation approach therefore elevates corporations law above tort law without necessarily giving due regard either to the policy interests represented by tort law[162] or to the adjudicatory challenges it presents to courts.

Second, the corporation approach is too extreme and the exceptions it espouses as noted above do not have a clear cut guiding principle. That is, while some of the exceptions are well grounded others are not. Fraud, deceit,

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[160] There have been arguments whether the tortious liability of directors to third parties amounts to lifting the corporate veil. See Jason W. Neyers, "Canadian Corporate Law, Veil-Piercing, and the Private Law Model Corporation" (2000) 50 U.T.L.J. 173 at 180. However, directors' tortious liability has been categorized as one of the situations when courts have and will pierce the corporate veil. See Yalden, *supra* note 6 at 168. In addition, the court in *Salomon* was ready to remove the veil of incorporation on grounds of fraud and dishonesty, which are also immutable grounds upon which directors can be held liable in tort to third parties. *Salomon, supra* note 6 (Comments of Lords Halsbury and Macnaghten at 33 and 52 respectively). See also *ScotiaMcleod, supra* note 83 at 720 where the court stated that "[t] hose cases in which the corporate veil has been pierced usually involve transactions where the use of the corporate structure was a sham from the outset or was an afterthought to a deal which had gone sour."

[161] Woods, *supra* note 58 at 1180.

[162] Argument proffered by proponents of the corporations law approach that tort policy objectives are to be discarded if corporations law and the corporate entity are to have a meaningful existence on the legal landscape, can also be advocated for the tort law approach. It can also be said that the corporations law objectives may need to be discarded in order to uphold the doctrinal principles attributed to tort law.

dishonesty and want of authority as exceptions appear to be reasonable. Such elements will not only show personal action and an advancement of a director's own personal interest but will also aid the court in determining the level of wilful participation of the tortfeasor director.[163] However, the "themselves tortious" and "separate identity or interest" element are sources of confusion for lower courts. This constitutes the third ground for criticizing the corporations law approach.

As stated above, the phrase "[the directors] actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own" is problematic. Because *ScotiaMcleod* did not explain this phrase, courts have attached various interpretations to it. One issue is whether the court perhaps actually intended the word "and" rather than "or" in the quotation given just above.[164] One view is that, for a director to be held personally liable for her actions, her actions must be "themselves tortious" ***and*** have separate identity or interest from that of the company thereby making the act complained of the director's. It means that two tests, which have been described jointly as an independent action,[165] must be satisfied before personal liability can be imputed.

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[163] See also *Leon Van Neck supra* note 151 para. 130. (Court stated that it is usually difficult to distinguish a director's independent tort from that of the company where there is no evidence of fraud, deceit, dishonesty or want of authority).

[164] *Strata Plan LMS 2643 v. Harold Developments Limited* [2007] B.C.J. No. 1639 (B.C.S.C.) [*Harold*]. (Court decided in favour of the "or" interpretation). Prof. Edward M. Iacobucci has suggested that in order to reconcile the two legs of the decision there is the need to read the "or" conjunctively rather than disjunctively. See Iacobucci, *supra* note 150 at 42.

[165] *Leon Van Neck, supra* note 151 at paras. 130 and 132.

In *Harold*,[166] for example, the defendants argued that for an action in tort to lie against a director, the plaintiff must show that the individual committed a tortious act which demonstrated an identity or interest separate from that of the company. The plaintiff must be able to show an independent cause of action against the defendant directors separate from that against the corporation. The defendants relied on the decision in *Strata Plan LMS 1965 v. 450526 B.C. Ltd*[167] where the court refused an application to join certain officers of a corporation on the ground that the construction services negligently performed by the officers were also the services undertaken by their corporation. The court in *Harold* recognized the uncertainty in the law but rather than let the officers off on the ground that no independent cause of action was pleaded against them, the court allowed the issue of liability to be decided at trial when all the facts are available.

The alternative interpretation advanced on the *ScotiaMcleod* test quoted above is that a director is personally liable when the director's actions are themselves tortious thereby making the acts or conducts complained of his own ***or*** when her actions have separate identity or interest from that of the company thereby making the act or conduct complained of that of the director. This means that the director's actions need not have a separate identity or interest from that of the company in order to found liability nor is any independent cause of action

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[166] *Supra* note 164 at para. 16.

[167] [2002] B.C.J. No. 407, B.C.S.C. 155 (B.C.S.C.). Defendants further relied on *Jam's International Ventures Ltd. v. Westbank Holdings Ltd.* [2003] B.C.C.A. 232 (The court of appeal dismissed the plaintiff's application for leave to appeal the decision of the lower court refusing to add a director in a claim for negligence and misrepresentation).

required for liability to attach.[168] In other words, the same facts upon which the company is prosecuted can be relied on to prosecute the director. It will suffice if the actions are "themselves tortious".

The difficulty with this interpretation is that *ScotiaMcleod* did not provide us with an interpretation for "themselves tortious" as contained in the first leg either due to an omission or because the court did not consider it to be a separate test. Assuming the former is the case, interpretative assistance is provided in *Alper Development Corporation v. Harrowston Corporation.*[169] Here the Ontario court of appeal held that the alleged failure of the vice president to insure or file insurance claims on behalf of his company could warrant him being held liable in negligence having breached a duty of care personally owed to the plaintiff co-contractor. The court therefore allowed the negligence action against the vice president to go to trial as the allegations identified conduct which was itself tortious.[170] The result of such an interpretation would create a situation where liability would attach to all facts exhibiting elements of a tort.[171] This interpretation also makes the second part of the test redundant. With the various interpretations listed above, it appears that *ScotiaMcleod* has produced a confusing state of the law.

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[168] See *Glenayre Manufacturing Ltd. v. Pilot Pacific Properties Ltd.*[2003] B.C.J. No. 456 (B.C.S.C.) where the court relied on *London Drugs Ltd. v. Kuehne & Nagel International Ltd.* [1992] 2 S.C.R. 299, 97 D.L.R. (4th) 261, 72 B.C.L.R. (2d) 1 (S.C.C.) [*London Drugs*] (Employees found negligent but were able to shelter under a limitation of liability clause).

[169] [1998] O.J. No. 1199, 38 O.R. (3d) 785, 107 O.A.C. 318.

[170] *Ibid.*, para. 8

[171] Prof. Nicholls states that *Alper Development* results in the proposition that anyone who has been proven to have committed a tort should be held liable, and that plaintiffs must be compelled to plead specific facts in support with such a claim. See Nicholls, *supra* note 3 at page 15.

The above confusion notwithstanding, the indisputable focus of the court in *ScotiaMcleod* is to impute liability where the director has made the action his own, whether by the action being "themselves tortious" or where the director pursues an interest different from that of the corporation. It will therefore be safer and less confusing to read "or" conjunctively in order to achieve the end result.[172]

Even the phrase "make the tortious act his own" is not bereft of controversy. Professor Robert Flannigan has commented that the phrase "make the tortious act his own" has been questioned and termed unenlightening. He states that courts have interpreted it to mean a separate interest or an assumption of responsibility on the part of directors.[173]

Another failing of the Corporations Law approach is that it might take us to an undesirable level of dispensation whereby the corporation becomes a shield to cover the erring director. This will open the door to the risk that directors will perpetrate wrongs on the basis that they largely cannot be held accountable. For example the directors in *Normart* escaped liability for conspiracy to injure because the wrong in issue was caused by the new corporation (1133373 Ontario Inc.) incorporated by the same directors for the sole purpose of keeping Bond Lake out of the plaintiff's reach.[174] The resulting effect of applying the Corporations Law approach to this case was that the

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[172] Iacobucci, *supra* note 150.
[173] See Flannigan, *supra* note 4 citing *Microsoft Corporation v. Auschina Polaris Pty Ltd.* [1996] 142 A.L.R. 111 at 124 (F.C.A.).
[174] *Normart, supra* note 152 at 630.

directors were able to actually profit from their wrongdoing to *Normart Management*.

Likewise in *Schmidt*, the director was relieved of liability because his actions, though specifically pleaded, could not be separated from that of the company.[175] That said, the director would have avoided liability in any event as the injury suffered by the plaintiff arose from factors independent of the director and his corporation's acts.[176]

The potential unfairness of the Corporations Law approach is exemplified in *Hoare v. Tsapralis*[177] where facts pleaded by the plaintiff showed that the defendant director had taken actions and given instructions for the demolition of a building constituting the tort of waste. Notwithstanding this, the court went on to relieve the director of liability relying on *ScotiaMcleod* and on the ground that evidence proffered did not show that the director was acting in his own interest as opposed to that of the corporation or that he was acting outside the scope of his employment or in a manner inconsistent with the object of interests of the corporation.

At the end of the equation is the whittling effect that Corporations Law approach has on the deterrence essence of tort law. Tort law becomes a dog with the ability to bark but incapable of biting. The courts' failure to apply the basic

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[175] *Schmidt, supra* note 151 at paras. 8-10.
[176] *Ibid.* at para. 37.
[177] [1997] 10 P.P.R. (3d) 89 at para. 16 (Ont. Gen. Div.), aff'd on other grounds [1999] O.J. No. 116, 117 O.A.C. 396 [*Hoare*]. See also *Alfano v. KPMG Inc.* [2000] O.J. 1634 (Ont. S.C.J.) (The court dismissed a claim of negligent misrepresentation against a director and a senior officer on the ground that the representations made were not in their personal capacities but rather as officers of the corporation.)

principle of tort as to personal liability will be to deny tort law of one of its cornerstones, that of deterrence.[178] In addition, this approach will not ultimately advance the compensatory goal of tort law when the plaintiff's only claim will sound against an insolvent corporation.

3.3 Tort Law Approach

3.3.1 Analysis

It is well known that directors are agents for the corporation and that agents are generally responsible for their tortious acts. By reason of this, directors are said to be responsible for their tortious conduct notwithstanding that they acted within the scope of their authority and in the best interest of the corporation. The blueprint for this approach was laid down in *Adga International Ltd. v. Valcom,*[179] a decision which came several years after *ScotiaMcleod.* In *Adga,* the directors of the defendant rival corporation lured the employees of the plaintiff corporation in order to win a contract bid. It was held that directors can be held liable for their torts so long as the pleadings allege tortious conduct of the individual director with the required specificity. According to Carthy J.A.:

> Canadian authorities at the appellate level confirm clearly that employees, officers and directors will be held personally liable for tortious conduct causing physical injury, property damage or

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[178] Linden, *supra* note 10 at 6-7.

[179] *Adga, supra* note 2. This decision has been followed in subsequent cases. See *Hawley v. Single Source Communications Inc.* [1999] O.J. No. 4947 (Ont. Sup. Ct.); *Meditrust Healthcare Inc. v. Shoppers Drugmart* [1999] O.J. No. 3243, 124 O.A.C. 137 [*Meditrust*], *Fullowka v. Royal Oak Ventures Inc* [2004] N.W.T.J. No. 64 para. 629 (N.W.T.S.C.); *Brodie v. Thomson Kernaghan & Co.*[2002] O.J. No. 1850 para. (Ont. Sup. Ct.) (where it was relied on to hold a director liable in negligence); and *NBD Bank, Canada v. Dofasco Inc.* [1999] 46 O.R. (3d) 514 (C.A.) [*NBD Bank*].

> a nuisance even when their actions are pursuant to their duties to the corporation.[180]

According to the court, the only exception to a director's liability for her own tort is the *Said v. Butt* defence whereby a director is absolved of liability for inducing breach of contract involving the corporation and the third party, provided that the director acts *bona fide* within the scope of her authority.[181] Apart from this solitary defence, liability will attach notwithstanding corporate authorization of the directors actions or that the action was of and intended to be in the interests of the corporation.[182] In the opinion of the court in *Adga*, everyone must be responsible for their actions, directors inclusive.[183]

It appears that the court in *Adga* was influenced in its analysis by an earlier decision of the Supreme Court of Canada in *London Drugs.*[184] Here, employees were negligent while performing a contract between their corporation and a third party. But for being able to shelter under a limitation of liability clause, these employees would have been fully liable for their own negligence to

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[180] *Adga, ibid* at 360 para. 26.

[181] The *Said v. Butt* exception did not avail the directors of Valcom because the breach of contract did not involve Valcom. In fact Valcom itself was said to have induced the breach of contract of employment between *Adga* and its employees. Invariably, the exception will only arise where the corporation is held liable for a breach of a contract and its directors for the inducement of that breach as a result of their directorial duties. See also *Einhorn v. Westmount Investment Ltd.* [1970] 73 W.W.R. 161 (Sask. C.A.) where it was stated that the general principle that directors of a limited company acting within the scope of their authority were not liable in tort for inducing or procuring a breach of contract by their principal was subject to certain exceptions like bad faith.

[182] Flannigan, *supra* note 4 at 291.

[183] *Adga, supra* note 2 at para. 18. Also, according to Justice Tallis in *Morgan v. Saskatchewan* [1985] 31 B.L.R. 173 at 180-81 (Sask. C. A.):

> [A] director is not to be held liable merely because he is a director but may be liable when he participates in or orders a tortious act and cannot escape personal liability by asserting that his act was merely the act of the corporation. In other words, the "corporate veil' is not to be used as a shield to protect shareholders and directors when they have been guilty of wrongdoing. This approach is consistent with the notion that everyone should be answerable for his tortious acts.

[184] *Supra* note 168.

their employer's customer.[185] It has been suggested that the court in *Adga* did not consider it fair or reasonable to allow directors to "stand in a better position than employees" when both are carrying out duties to the corporation.[186] Thus, if *London Drugs* held that employees could be liable for wrongs done in the course of performing their duties to the corporation, there is no reason why directors should be absolved of responsibility for their actions carried out within the scope of their duties to the corporation.

Based on the court's reliance on *London Drugs*, it can be seen that *Adga* proceeds from the point of recognizing the need to make everyone accountable for his actions. This is a position that elevates tort law over corporations law. The court also recognizes the need to exempt certain situations from a strict application of this rule, given the importance of directors to the proper running of business. The court therefore worked its way back to single out the business tort of inducing breach of contract as being the only tort for which directors might escape liability.

The origin of the tort of inducing breach of contract as it relates to corporate directors is often traced to the English case of *Said v. Butt*[187] and has

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[185] *Ibid.* at 369-370 (cited to D.L.R.).

[186] Colin Feasby, "Corporate Agents' Liability in Tort: A Comment on *Adga International Ltd. v. Valcom Ltd.*" (1999) 32 Can. Bus. L.J. 291 at 295. See also *Adga, supra*, note 2 at para. 43.

[187] [1920] 3 K.B. 497. See also *Lumley v. Gye* [1843] All E.R. 208 [*Lumley*] on the development of a general principle of tortious liability for interfering with contractual relations. According to Cromption J.:

> a person who wrongfully and maliciously, or which is the same thing, with notice, interrupts the relation subsisting between master and servant by procuring the servant to depart from the master's service ... whereby the master is injured, commits a wrongful act for which he is responsible at law.

See also Mitchell E. Kowalski, "Circumventing the Corporate Veil to Attack Unscrupulous Directors" (2001) 39 R.P.R. 249.

been followed in a number of Canadian cases.[188] The elements of the tort are: (1) there must be an existing contract between the plaintiff and another party; (2) the defendant, by his conduct, intended to cause the breach; (3) the defendant must be aware of the existence of the contract and its terms; (4) the defendant's conduct must have induced the breach; (5) the plaintiff must have suffered damages; and (6) the defendant must have acted without justification.[189] In other words, the defendant must have knowingly and without justification induced one of the parties to a contract to breach the contract thereby resulting in damages to the plaintiff.[190]

However, liability ceases to flow where the tortfeasor is a director who, acting within her authority, makes a business decision that causes her corporation to breach a contract.[191] The general rule that directors are liable for their own torts will give way in the face of inducement of breach of contract when the director fits the standard articulated in *Said v. Butt*.

A number of reasons have been advanced for this exception. First, directors have been regarded as agents and alter ego of the corporation.[192] As alter egos, their actions can only be regarded as that of the corporation and they

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[188] The Canadian courts recognize the tort of inducing breach of contract where there is any unjustifiable and unlawful violation of economic interest which causes harm. See *McFadden v. 481782* [1984] 47 O.R. (2d) 134 (H.C.J.) [*McFadden*]. In this case the court stated that an agent who acts in good faith and in the interest of his principal and in accordance with his duties is protected from liability in an action for inducing the breach of contract. The directors were however held liable for inducing breach of contract because their actions were motivated by their self-interests at para. 42. See also *Einhorn supra* note 181.

[189] Klar, *supra* note 10 at 610 and Bruce Welling et al., *Canadian Corporate Law: Cases, Notes & Materials*, 3d ed. (Toronto: Lexis Nexis Butterworths, 2006) at 169.

[190] Kowalski, *supra* note 187. See also Erle J. in *Lumley, supra* note 187 describing the offence as one for the "procurement of the violation of a right".

[191] See *Said v. Butt, supra* note 187 at 505 - 506; See also *Adga, supra* note 2 at paras 18, 34 and 41.

[192] *Said v. Butt, ibid.*

therefore cannot be held liable for such acts. To hold so will be tantamount to holding the corporation liable for breaching a contract of which it is a party and at the same time liable for inducing the breach of the same contract.[193]

Secondly, courts have exempted directors from tortious liability on justification grounds.[194] In other words, notwithstanding general applicability of tort law to all persons (directors inclusive), a director who shows that he acted under the compulsion of a duty to the corporation will be exempted from liability.[195] An example of such a duty is the statutory and common law duty to act in the best interest of the corporation. Where a director considers it economically viable for a corporation to refrain from performing a contract to a third party, she may take steps to induce non-performance on the part of the corporation. That is, a director who is acting in the best interest of the corporation is entitled to consider the transaction cost *viz a viz* the cost of damages for non-performance and advise her corporation not to perform the contract based on that calculation. This latitude ensures that corporations retain the requisite power to decide to either continue with the contract or pay damages in lieu. This is consonant with Oliver Wendell Holmes' Bad Man Theory of law as applied to contracts. For Holmes, parties to a contract are promising to

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[193] This reasoning is consonant with the corporation law approach. However, Callon J. in *McFadden, supra* note 188 rejects this reason when he states that directors are relieved of personal liability in tort cases not because they are the company's alter ego but rather because they are justified by reason of their duty to the corporation.

[194] *Quinn v. Leatham* [1901] 1 A.C. 495 at 510, *per* Lord Macnaghten. See also *McFadden, ibid.*

[195] According to Welling, *supra* note 56 at 172:

> the defence of justification is available when the defendant caused the breach while acting under a duty imposed by law. The issue in each case is whether upon consideration of the relative significance of all the factors, the defendant's conduct should be tolerated despite its detrimental effect on the interests of others.

perform or pay damages in lieu of performance.[196] Hence, decisions relating to whether to perform or breach a contract are informed by their material consequences and should not be subject to moral criticism.[197] Along this line of thinking, directors should therefore be exempted from moral and legal culpability in the face of economic advantage to the corporation.

Directors' justification for inducing the breach of a corporation's contract is also supported by the doctrine of economic breach as analysed by Richard Posner.[198] According to Judge Posner, where the profit from breach exceeds the promisor's profit from completion and the promissee's expected profit from completion of the contract, an incentive to breach the contract arises.[199] Directors may therefore be encouraged to induce the promisor corporation to breach a contract where such breach is *pareto superior* or will amount to an efficient breach.[200]

Carthy J.A. of the Ontario court of appeal in *Adga* would agree with this kind of reasoning as evidenced by his account on the *Said v. Butt* exception:

> [The] exception has since gained acceptance because it assures that persons who deal with a limited company and accept the imposition of limited liability will not have available to them both a claim for breach of contract against a company and a claim for tortious conduct against the director with damages assessed on a different basis.
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> [Secondly, it] assures that officers and directors, in the process of carrying on business, are capable of directing that a contract of employment be terminated or that a business contract not be

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[196] Holmes, supra note 5 at 462 cited in Christine Boyle and David R. Percy ed. *Contracts: Cases and Commentaries,* 7th ed. (Ontario: Thomson Carswell, 2004) at 822.
[197] Holmes, *ibid.* at 459-462.
[198] Richard Posner *Economic Analysis of Law,* 6th ed. (New York: Aspen Law & Business, 2003) 119-120.
[199] *Ibid.*
[200] *Ibid.*

> performed on the assumed basis that the company's best interests to pay the damages for the failure to perform.[201]

According to Carthy J.A. in *Adga* these concerns are necessary:

> ... because business cannot function efficiently if corporate officers and directors are inhibited in carrying on a corporate business because of a fear of being inappropriately swept into lawsuits, or, worse, are driven away from involvement in any respect in corporate business by the potential exposure to ill-founded litigation.[202]

Another reason advanced in support of this exception is that it captures an inherently non-tortious situation. It has been argued that director's protection, in cases which otherwise will have amounted to inducing breach of contract, should not be regarded as an exception but to buttress the fact that "there is simply no tort..."[203] Properly regarded, the corporation was not "induced to breach the contract. Its own internal decision-making mechanisms produced the breach. No external force influence on the part of someone of lacking authority was involved."[204] Going by Robert Flannigan's analysis, no tort is committed by directors who have authority to perform the action. However, where they lack authority, they are interfering with contractual relations between two parties and will be liable.[205]

Save for the *Said v. Butt* exception, the general conclusion under the Tort Law approach is that directors are liable for their torts. This however brings us back to the controversial question whether the Tort Law approach of *Adga* is

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[201] *Adga, supra,* note 2 at 357 para. 15
[202] *Ibid.* In *Best v. Spasic* [2004] O.J. No. 5765 (Ont. Sup. Ct.) at para 14, the court observes that the *Said v. Butt* exception is aimed at protecting honest efforts of officers performing the corporate contractual will.
[203] Flannigan, *supra* note 4 at 278.
[204] *Ibid.*
[205] *Ibid.*

consistent, as it claims to be,[206] with the Corporations Law approach of *ScotiaMcleod*. That is, does *Adga* truly follow *ScotiaMcleod* or has it charted a different course foreign to the intention in the latter? According to *Adga* "[t]he consistent line of authority in Canada, holds simply that, in all events, officers, directors and employees of corporations are responsible for their tortious conduct even though that conduct was directed in a *bona fide* manner to the best interests of the company, always subject to the *Said v. Butt* exception".[207] *ScotiaMcleod,* on the other hand, states that directors are protected from personal liability except where it can be shown that they have left their duties as directing mind of the corporation and made the tort their own.[208] These two statements of law appear to be opposed and therefore have led to confusion. Two lines of authority have functionally emerged for lower courts to follow.

The reality of the controversy is shown in several decisions which tried to follow the statement in *Adga* claiming that both *Adga* and *ScotiaMcleod* apply the same approach. For instance, both decisions were relied on in *Meditrust*[209] to conclude that a claim in tort *may* proceed against directors for acts performed in the course of their duties provided that the tortious acts are properly pleaded and subject to *Said v Butt.* Of particular interest is the fact that the lower court in *Meditrust* relied on *ScotiaMcleod* in striking out the claims against the directors.[210] According to Labrosse J.A. in his lead judgment, Carthy J.A. (in

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[206] See *Adga, supra* note 2 at para. 18 where Carthy J.A. reiterates that *ScotiaMcleod* is not inconsistent with *Adga.*
[207] *Ibid.* at 358 para. 18
[208] *Supra* note 83 at 721.
[209] *Supra* note 179 at para. 14.
[210] *Meditrust, ibid.* at para. 5.

Adga) merely restated the words of Finlayson J. A. in *ScotiaMcleod.*[211] However, the general usage of the word "may" would imply an exception (as intended by *ScotiaMcleod)* as opposed to a general rule (as intended by *Adga*). Invariably, it is difficult to conclude that a line set out to make an event an exception would be the same as a line that seeks to make that event a general rule. This is an obvious distinction between *ScotiaMcleod* and *Adga.*

Logically, *Adga* is not commensurate with *ScotiaMcleod.* If *ScotiaMcleod* equals *Adga*, then Valcom Ltd.'s director and officers should have been exonerated because they did not fall under any of *ScotiaMcleod's* exceptions to the rule that directors are not personally liable. Not only were they acting on behalf of Valcom Ltd., but they also had not committed a fraud nor acted outside their authority. Furthermore, they had not made the tort their own (no personal interest attributable to them) nor were their action tortious in itself (in the light of the earlier discussed interpretations). On this basis, no other person other than Valcom Ltd. should have been held liable for the commission of the tort. Following the decision in *ScotiaMcleod*, the necessary conclusion should be that the Valcom directors, by interviewing the officers of *Adga* in order to recruit them to Valcom, were only directing the mind and affairs of Valcom Ltd. Therefore "their exposure, if any, [should be] narrowly focused on their formal decision-making"[212] in the name of Valcom.

A different outcome would have resulted in *Adga* if the court had followed *Normart's* application of *ScotiaMcleod* that "directing minds of the

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[211] It is interesting to note that Carthy J.A. was a member of the panel in *Meditrust.*
[212] *ScotiaMcleod, supra* note 83 at 720.

corporations cannot be held civilly liable for the actions of the corporations they control and direct unless there is some conduct on the part of those directing minds that is either tortious in itself or exhibits a separate identity or interest from that of the corporations such as to make the acts or conduct complained of those of the directing minds".[213] It is unclear how the court in *Adga* could reach a conclusion that the act of the Valcom directors was in any way different from that of Valcom or that the act was in fact made their own. The actions of the directors were business decisions made in the best interest of Valcom, in good faith and within the scope of their directorial duties.[214] Whether or not they have acted in bad faith cannot be deduced merely from the fact that they were furthering the business interest of their corporation and neither should Valcom directors be liable merely because they are directors.

The distinction in the two approaches is made clearer by the fact that the divisional court in *Adga* reached a different conclusion based on the application of the tests set out by the court of appeal in *ScotiaMcleod.* The lower court held that there were no allegations of fraud, malice or personal profit on the part of the directors to create triable issues as the acts of the directors were in fact the acts of the company.[215]

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[213] *Normart, supra* note 152 at 633 para. 18.

[214] *Alie v. Bertrand & Frere Construction Co.* [2000] O.J. No. 1360 (Ont. S.C.J.). This case involved a director who had instructed the introduction of fly-ash into concrete which subsequently caused the failure of the concrete. In refusing to hold the director liable in negligence, the court mentioned *Adga* but relied on *ScotiaMcleod* and its requirement of fault and the need for the act in question to exhibit a separate interest from that of the corporation.

[215] *Adga International Inc. v. Valcom Ltd.* [1997] O.J. No. 4110 paras. 16-18 (Div. Court). Even the court of appeal in *ScotiaMcleod* expressed its disapproval of a broader liability while allowing the allegation against the two executive directors to go to trial. It was expressly stated that the appeal against the executive directors was only allowed because of the low requirement for sustainability of pleadings. According to Finlayson J. at 725, the plaintiffs were just

In addition, as much as the court of appeal in *Adga* tried to liken its analysis to *ScotiaMcleod*, commentators[216] have stated persuasively that *Adga* departed from the *ScotiaMcleod* decision.[217] It appears that the court of appeal in *Adga* was trying to force a square peg into a round hole and essentially reversed *ScotiaMcleod* without admitting it. As Christopher Nicholls observes, "[i]t is … difficult to accept the proposition that *Adga* represented no change in the law…"[218] He went on to refer to the court of appeal's earlier decision in *Budd v. Gentra Inc.*[219] where the court opined that based on the fact that corporations must always act through persons such as directors, the corporation alone should be held liable for torts committed against third parties. In Nicholls' opinion, *ScotiaMcleod* and *Budd v. Gentra* (following *ScotiaMcleod*) appear to posit that a tort committed by directors as a directing mind of the corporation should be borne by the corporation alone and not the individual director.[220]

Sounding the same note, Brennan J. has been quoted to comment that:

> It was no easy task to reconcile [these] decisions - to me they seemed contradictory in the principles to be applied. Putting it simply *ScotiaMcleod* seemed to be saying corporate directors should rarely be joined in actions against the corporations, and

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"attempting to stretch the envelope of available jurisprudence to encompass the acts of [the two executive directors]…".

[216] Nicholls, *supra* note 3 at 12-13; see also Janis P. Sarra and Ronald B. Davis; *Director and Officer Liability in Corporate Insolvency: A Comprehensive Guide to Rights and Obligations* (Butterworths Canada: Markham, 2002); see also Brennan J., "Recent Developments in Directors' and Officers' Tort Liability" Civil Litigation Update 2000 (2000) at tab 14, page 1 cited by Debenham, *supra* note 78 at 318.

[217] The persuasion in this line of thought lies majorly in the fact that while *ScotiaMcleod* proceeds from a point of no personal liability but for exceptional circumstances, the Court of Appeal in *Adga* at 358 para. 18, states that directors' personal responsibility for their tortious actions whether or not done in the course of their duty to the corporation or in the best interests of the corporation, has been consistently held by previous Canadian decisions. The only exception to this rule relates to the tort of inducing breach of contract as discussed earlier.

[218] *Supra* note 3 at 19.

[219] [1998] 43 B.L.R. (2d) 27, 111 O.A.C. 288.

[220] *Supra* note 3 at 19.

> would be entitled to dismissal of the claims against them by striking out the pleadings or summary judgment, subject to exceptions. *ADGA* on the other hand seemed to say the opposite, that directors and officers were easy targets...[221]

Even supporters of the *Adga* doctrine note the awkwardness of the purported reconciliation carried out by the court of appeal in *Adga* in trying to harmonize the two cases.[222]

The court in *Adga* worked to avoid the injustice that a strict application of *ScotiaMcleod* would produce by advancing a broader approach to director's liability while leaving a small window of protection that acknowledges the policy goals of corporations law and invariably, the policy considerations of *ScotiaMcleod* in relation to the tort of inducing breach of contract. Rather than admit to this reversal, the court couched its activity in language insisting that *ScotiaMcleod* was being applied.

Having argued that there is indeed a distinction between *ScotiaMcleod* and *Adga*, this thesis will consider whether the Tort Law approach promoted by *Adga* is the correct position in this area of law.

3.3.2 Scholarly Reaction to Tort Law Approach

The application of the Tort Law approach is objectionable on four grounds. First, it creates confusion as per the above discussion. Second, it provides no seasoned analysis for adopting *Said v. Butt* as the sole exception. Third, it may lead to overdeterrence and ultimately economic crisis in the

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[221] Brennan J., *supra* note 216, quoted by Debenham, *supra* note 78 at 318.
[222] Debenham, *ibid.*

running of corporations. Fourth, it unfairly expands the law on directors' liability. These reasons are furthered explained below.

As earlier stated, the Tort Law approach as articulated in *Adga* has created confusion in the state of the law on directors personal liability. It has set the stage for two lines of authority. Courts are now found to either apply Corporations Law approach as expounded in *ScotiaMcleod* or the Tort Law approach as stated in *Adga*. Other courts even purport to apply *Adga* while in fact applying the principles in *ScotiaMcleod* and *vice versa*. This is all regrettable from the perspective of certainty.

Furthermore, the Tort law understanding of the *Said v. Butt* exception is bereft. Indeed the exception is factually nothing more than a reverse way of stating *ScotiaMcleod* and its Corporations law approach. If one agrees with McCardie J.'s reasoning in *Said v. Butt* that directors are the *alter ego* of the corporation, it is no more than agreeing that directors are "the directing minds" of the corporation. Taking this argument further, then there is no reason why their exemption from liability should be limited to inducement of breach alone. They continue to act as *alter ego* even in other situations resulting in torts. Directors' protection should therefore cover all tort cases where they have acted in the course of their duties to the corporation. If this is correct, one is led inexorably back to the Corporations Law approach.

Further, the court of appeal in *Adga* does not make the ambit of the *Said v. Butt* exception clear. This has seen lower courts expanding its scope while struggling to grapple with the 'so-called' reconciliation of *Adga* and

ScotiaMcleod. For example, in *Fraiberg v. CT Financial Services Inc.*[223] the court dismissed claims in negligent misrepresentation instituted against a director who had negotiated certain share purchase agreement and employment contracts on behalf of his company. The plaintiff sought to hold the director personally liable for those representations made by him on behalf of the corporation. The motion court expanded the *Said v. Butt* exception to this negligence scenario by holding that the director's actions were within the scope of his employment and could therefore not be held personally liable for them.[224]

In addition, it has been argued that over-deterrence, as expounded by *Adga,* does not create a principled basis for limiting director's protection to inducing breach of contract. The same reason can be advanced for all other torts. In other words, this should create a situation where directors acting *bona fide* within the scope of their authority would never be found personally liable for their torts. This argument is clearly stated by Edward Iacobucci as follows:

> [T]he court [in *Adga*] implicitly accepted the premise that costly overdeterrence of torts is of importance when analyzing directors' personal liability, yet it considered this quite general principle in only a particular subset of cases, namely those involving the tort of inducing breach of contract. There is, in my view, no principled reason to conclude that overdeterrence is only relevant to the tort of inducing breach of contract. Consideration of overdeterrence in all tort contexts could undermine the basis for ever finding personal liability.[225]

Finally, in a bid to uphold the tort principle of everyone being accountable for his own wrong, *Adga* fails to recognize the distinction between

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[223] [1999] O.J. No. 2063 (Ont. S.C.J.).
[224] *Ibid.* para 6. For further examples on other occasions where courts have expanded the *Said v. Butt* exception see Debenham, *supra* note 78 at 329-330.
[225] Iacobucci, *supra* note 150 at 39-40.

intentional torts and the tort of negligence. It applies the same general rule to both forms of tort thereby creating an expansion which may create unfairness. As Colin Feasby notes, *Adga* "suggests that the reasons for attributing personal liability for corporate torts to corporate agents should be the same whether the tortious act is intentional or a failure to take due care."[226] *Adga's* inability to calibrate its approach is also its biggest weakness.

3.3.3 Effect of Tort and Corporations Law Approach Summarized

One conclusion deducible from *ScotiaMcleod* is that directors who commit intentional torts like battery, assault and fraud would be held liable notwithstanding the fact that they act as directing mind of the corporation.[227] However, the problem of applying the rule in *ScotiaMcleod* arises where negligence is alleged. For instance, according to the facts of *ScotiaMcleod,* all the directors of Peoples Jewellers were alleged to have collectively made negligent representations thereby causing injury to the plaintiff. Nonetheless, only the two executive directors against whom wrongful acts were specifically pleaded had to face trial while the others (who were merely roped in as a result of their status as directors) were relieved at application stage. The others were exonerated because there were no specific allegations of "[activities] on their part that takes them out of the role of directing minds of the corporation".[228]

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[226] Feasby, *supra* note 186 at 298.
[227] There are still certain cases where liability is not imputed. See for example, *Hoare supra* note 177 where a director who directed the demolition of a building was exonerated from liability on the ground that his interest was not different from that of the corporation.
[228] *ScotiaMcleod, supra* note 83 at 721.

Further, although the court of appeal considered that there were sufficient facts to go to trial in the case of those two executive directors, it also expressed its opinion that the respondents were merely trying to "stretch the envelope of available jurisprudence"[229] to pursue claims against them. The effect of *ScotiaMcleod* is that directors who have been negligent in their general duties may most likely escape liability as directing minds of the corporation.

The application of *Adga* and its Tort Law approach would also undoubtedly bring liability on a director committing an intentional tort. Unless the intentional tort happens to be in the inducing breach of contract context, the *Said v. Butt* exception would not come to his aid and neither would the need for overdeterrence be a consideration to relieve him of liability. However, as earlier stated, the strong whip wielded by *Adga* does not stop with intentional torts but covers the wide field of negligence as well. The current position under the Tort Law approach would create a situation where a director would most likely incur liability for every form of negligence, the degree notwithstanding.

In sum, inconsistencies arise between the *ScotiaMcleod* approach and the *Adga* approach in the context of a negligence action. These two approaches would produce the same result in relation to intentional torts.

3.4 Conclusion

It is obvious that the two areas of law – tort and corporation – are strong forces whose principles should not be compromised except where it becomes

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[229] *Ibid.* at 725. See also Feasby *supra* note 186 at 295.

mandatory for justice to be served. Courts are therefore saddled with the responsibility of balancing these two principles in order to justifiably resolve tortious acts of directors coupled with the herculean task of reconciling the above-mentioned two lines of authorities in the Canadian corporate legal sphere.

This part of the thesis has examined the current confused state of the law in Canada while highlighting the precariously uncertain position in which corporate directors find themselves. In order to circumvent this uncertainty, there is need to devise another approach which would aptly cover negligence while not neglecting to ensure that fairness and efficiency values are employed. The next part will apply the theoretical construct suggested in part II to create a test to guide Canadian courts in resolving the question of directors' liability for tort to third parties.

PART IV APPLICATION OF CULPABILITY THEORY TO CANADIAN CASE LAW

4.1 Introduction

This part applies the culpability-based liability regime advocated in Part II above to decided cases in Canada with the goal of advancing a fresh and viable approach to the problem of directors' liability in tort. It also measures how commensurate the scheme is in relation to values expounded in relevant case law.

As already noted, there are three levels of culpability in the scheme proposed here. The first level refers to intentional torts (with the exception of inducing breach of contract); the second covers gross negligence; while the third covers ordinary negligence. Direct focus will be given to negligence here as intentional torts create little or no problems as earlier explained.

4.2 Mentmore and Culpability

Culpability as a determining factor in resolving directors' personal liability question is not a new innovation. Though earlier courts did not necessarily base their decisions on it, they still present some insight into how culpability is relevant. For example, *Mentmore* offers clarification on the suggested theory. In the 1978 decision of *Mentmore*, Justice Le Dain elevated policy concerns as the organizing principle going to whether directors should be liable in tort. According to Justice Le Dain, the correct test for determining a director's liability to third parties is one that leaves "[room] for a broad appreciation of the circumstances of each case to determine whether as a matter of policy they call for personal liability."[230] The court itself ultimately applied the Corporations Law approach because, in relieving the director from liability, it further stated that for personal liability to be imputed there must be a level of personal involvement by which the director makes the tort his own.[231] The court concluded that the fact that the director in this case (who was President and joint owner of the company and who directed the carrying on of the conduct

[230] *Mentmore, supra* note 138 at 205.
[231] *Ibid.* at 203

amounting to patent infringement) did not engage in conduct which suffice to reach this standard.[232]

The policy-centred approach expounded by *Mentmore* supports a more flexible understanding of the problem at hand and aids in resolving directors liability for ordinary or gross negligence. It gives the adjudicating judge ample room and discretion to determine whether liability can be fairly attributed to the director as a result of the measure of his culpability in the given case.

Mentmore was adopted by the court in the English case of *White Horse Distillers Limited v. Gregson*[233]. In this case the plaintiff had alleged that the defendants, whisky exporters, should be held liable for a passing off in England of labels similar to those of the plaintiff, which action was perpetrated by the defendants' local distributor in Uruguay. An earlier proceeding had been commenced which concluded in undertakings being given by the defendant corporation. Due to the subsequent passing off in breach of those undertakings, the plaintiff joined the two directors of the defendant corporation alleging that each was personally liable in tort together with their company. In holding the directors personally liable, the court stated among other things that individual cases must be considered to determine whether preference should be given to the principles of limited liability or separate personality on the one hand, or the principle that one must answer for one's tortious acts, on the other. The answer

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[232] *Ibid.*
[233] [1984] R.P.C. 61 (Ch.)

to the question would determine whether the directors should be held personally liable for their actions.[234]

Mentmore and *Whitehorse* are different from *ScotiaMcleod* and *Adga* because they give recognition to the cumulative policy concerns of both *ScotiaMcleod* and *Adga*. Nourse J. in *Whitehorse*, while trying to give a practical application of the *Mentmore* approach, explains that the facts of each case must be weighed against the application of the theoretical basis for the contending areas of law (tort and corporation). The question to be asked is whether from the facts of the case there is the need to override the basic principles of liability or rather the basic principles of corporations law. In *Whitehorse*, it was held that "there were no grounds of policy ... upon which the basic principles of [tort] liability ought to be overridden." The erring director was therefore held liable for the tortious conduct.

Applying *Mentmore's* policy-centred approach to the degrees of negligence (gross and ordinary) as earlier explained, could lead to the conclusion that directors should be liable for their negligence when it manifests the more extreme form of culpability found in gross negligence and be relieved of liability in the less extreme case implicit in ordinary negligence. Whether liability should lie for extreme forms of negligence would depend on the circumstances of each case and any set of facts not qualifying as such would

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[234] *Whitehorse* departed from the earlier English position set out by Atkin L.J. in *Performing Right Society Limited v. Ciryl Theatrical Syndicate Limited* [1924] 1 K.B. 1 where it was held that it is sufficient to show that the director expressly or impliedly directed or procured the commission of the tortious conduct. One of the directors was found personally liable as there were sufficient evidence to show his personal involvement as distinct from that of the corporation. The other director was however let off as his actions were merely hinged on his legal responsibility to the corporation.

therefore constitute ordinary negligence to which liability would not ordinarily be found.

The following system is proposed for the resolution of directors' liability in tort committed against third parties:

(1) First the court should scrutinize the facts before it to determine whether the wrongful act performed in the course of duty would constitute an intentional tort or negligence;

(2) If it is an intentional tort, the court should apply *Adga* thereby holding the director personally liable except where the intentional tort is an inducement of breach of contract as explained earlier. This is because a higher level of director's culpability will be made out in such circumstances. The director's fault becomes more apparent. In addition, policy considerations will *prima facie* favour director's liability;

(3) If the tort sounds only in negligence, the court should decide whether it is gross negligence or ordinary negligence;

(4) If gross negligence is established, the court should apply *Adga* as described in (2) above (with the exception of inducement of breach of contract). As earlier stated, the director's wrongful act will have exhibited sufficient fault tantamount to those found in intentional tort scenarios;

(5) If the facts constitute ordinary negligence, *ScotiaMcleod* and its broad protection should be adopted. The director's fault in such cases will usually be those inadvertent negligent acts arising from merely being a

director of the corporation through which the wrongful tortious acts have been committed; and

(6) As earlier mentioned, where the director, while acting *bona fide* in the best interest of the corporation, induces the corporation to breach its contract with a third party, then the exception set out in *Adga* and *ScotiaMcleod's* broad protection should be employed by courts.

The application of this flexible, policy-focused approach as advocated by *Mentmore* and *Whitehorse* is entirely consonant with the culpability theory advanced in Part II. There would be a legal dispensation for the directors where the Tort Law approach as set out in *Adga* applies (i.e. in intentional tort or where the director has been grossly negligent). There would be no likely escape for the director where the Corporations Law approach of *ScotiaMcleod* applies (i.e. where mere or ordinary negligence is alleged). A balanced and more flexible approach is therefore created which ensures that justice is served to all concerned. Though there are a great many cases on point, the next section analyses a few representative cases for illustration purposes.

4.3 The *ScotiaMcleod* Group of Cases as Measured against the Trigger of Culpability

This section will apply the culpability theory to some significant cases that have followed the *ScotiaMcleod* path to determine what the conclusion of each case would otherwise be.

4.3.1 *ScotiaMcleod*

As already noted, *ScotiaMcleod* let certain directors out of the action because they had not "made the tort their own" having only acted as the directing mind of the corporation. The other two executive directors were not as lucky because the court considered the specific allegations against them to suffice for a trial. In applying the scheme advanced here, the outcome would have been the same. The culpability theory would require that the court determine whether the negligent acts of the individual directors were gross or ordinary. In such circumstances the two uninvolved directors will easily be relieved of liability for negligently accepting as true the financial state of the company. This will do away with the confusion brought by judicial interpretation of the phrases "making the tort his own" and "themselves tortious". Their negligent omission to verify the financial state may be categorized as ordinary having not shown a knowing and deliberate action on their part. In fact, all they have done is merely to perform their directorial duties in the best interest of the company they represent.

The other two executive directors may be liable for gross negligence due to the fact that their actions verged on the intentional. Although the defendant who had joined these two directors as third parties did not make out a sufficient case against them, the pleadings showed that they made "certain representations personally which were relied upon by the defendants".[235] It would be open for the court to find against them for any material misrepresentations made which reached the standard of reckless.

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[235] *ScotiaMcloed, supra* note 83 at 719.

4.3.2 *Blacklaws*[236]

In *Blacklaws,* the defendant was the director/owner of 470433 Ltd. This numbered company owned Ghostpine Resort by virtue of a foreclosure. The defendant was accused by purchasers of timeshare in the resort of negligently performing his duties as manager thereby causing them to lose benefits that should have accrued to them as timeshare owners. The majority held that the director in question could not be liable in negligence merely because of his knowledge of a sewage problem which resulted in the loss of the benefit complained of.[237] There was no duty of care between the director and the timeshare owners. Rather, whatever duty was owed to the plaintiffs by 470433 Ltd.[238] On a related front, the loss complained of was pure economic loss carelessly caused and the facts did not justify extending liability for pure economic loss.[239] The dissenting judgment of Mr. Justice Berger would have held the director liable in negligence for failing to do what a reasonable person would do in the circumstance and in view of the fact that his failure to fix the sewage evidenced a separate identity or interest from that of the company, thereby making the act his own.[240]

Although the majority did not rely on culpability as the reason for judgment, this would have been a way of contradicting the dissenting judgment

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[236] *Supra,* note 83.
[237] *Blacklaws, ibid.* at para. 49.
[238] *Ibid.*
[239] *Ibid.* at paras. 50 and 81.
[240] *Blacklaws, ibid.* para. 169. This case is a vivid example of the confusion trailing the two different lines of authority – *ScotiaMcleod* and *Adga.*

of Mr. Justice Berger. Assuming a duty of care existed, the director's omission to correct the sewage problem did not attain the height of gross negligence. Accordingly, the director should be immune from liability based on the theory of culpability advanced here.

4.4 The *Adga* Group of Cases as Measured against the Trigger of Culpability

4.4.1 *Adga*

As already summarized, in *Adga* the directors and officers of Valcom Ltd. interviewed employees of their competitor, Adga Ltd. in order to convince them to allow their names to be used in a tender bid and on successful bidding to work for Valcom Ltd. In this way, the actions of Valcom directors clearly amounted to an intentional tort which leans heavily towards a finding of liability. The directors could not benefit from the "inducing breach of contract" exception, as set out under the case of *Said v. Butt,* because the wrong complained of was not as a result of their inducing the breach of a contract between their company and a third party. In view of this, the high level culpability manifest in intentional torts justifies a finding of liability

4.4.2. *NBD Bank*

NBD Bank, Canada v. Dofasco Inc.[241] is a post-*Adga* case in which negligent misrepresentation was alleged against a director and certain other officers. In this case, the director of Algoma corporation was alleged to have

[241] *Supra* note 179.

misrepresented facts relating to the financial status of Algoma thereby misleading the plaintiff bank, who relied on this information to extend credit facilities to Algoma. About two weeks later, Algoma went bankrupt and the Plaintiff bank was unable to recoup its money. The court of appeal, while affirming the judgment of the lower court, stated that there was no policy reason for excluding the director from personal liability for making such misrepresentations.[242] On this basis, the matter was permitted to proceed to trial.

It would seem that the director in question perpetrated negligent acts which bordered on an intentional tort. In fact, his actions verge on deceit as the facts show that he was the Vice President (Finance) and treasurer of the company and therefore knew of the financial challenges it faced. He cannot claim to have inadvertently made the untrue representations. As a result of this, the level of culpability to be imputed to him should be the high one which attaches to gross negligence.

4.5 *Peoples Department Stores (Trustee of) v. Wise* and Culpability

This thesis could not be successfully concluded without considering whether culpability theory is consistent with the decision of the Supreme Court in *Peoples Department Stores (Trustee of) v. Wise*.[243] The Supreme Court, while speaking *obiter*, stated that directors owe a duty of care to creditors,[244] a subgroup of third parties considered throughout this thesis.

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[242] *Ibid.* para. 44.
[243] *Peoples, supra* note 52.
[244] *Ibid.* para. 1.

The trustees in bankruptcy of Peoples Department Stores instituted an action against its directors for breaching their fiduciary duties under s. 122(1) of the CBCA to the company when they implemented certain policies which they considered to have being the cause of Peoples' bankrupt state. The court had to decide whether the directors owed a fiduciary duty to the creditors of the defunct corporation. While holding that the directors only owed their fiduciary duty to the corporation and not to the creditors or any other stakeholder, the Supreme Court also held that directors owed a duty of care to creditors by virtue of s. 122(1)(b) of CBCA.[245] Section 122 (1)(b) provides as follows:

> (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
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> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.[246]

By virtue of this decision, one might conclude that the Supreme Court has denied the possibility of a distinction between gross negligence and ordinary negligence which is so central to this thesis' culpability theory. However, this would be an erroneous conclusion. The Supreme Court, while recognizing that directors' duty of care is a "long-standing principle of common law",[247] explained that a determination of a breach of the duty will be considered contextually with special consideration given to the facts and the prevailing socio-economic conditions.[248] This opinion formed the basis for the court

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[245] *Ibid.*
[246] CBCA.
[247] *Peoples, supra* note 52 at para. 59.
[248] *Ibid.* para. 64

holding that the directors of Peoples did not breach their duty of care to the creditors.[249]

Likewise, the Justices at the court of appeal in *Peoples* were ready to distinguish between the levels of fault that will trigger a breach of the duty of care and that which will not and were not castigated by the Supreme Court for doing so.[250] For example, the court of appeal relied on the words of Gonthier J. in *Crevier v. Paquin* where he stated as follows:

> There is no need to point out the rather limited liability of directors recognized by the courts. They are personally responsible for the action of the company only if they commit a gross fault. It is accepted that directors must show fair and reasonable diligence in managing the company and act honestly, but no more than that, and it has been decided that they need not have special knowledge.[251]

Beyond this, it has been argued that the Supreme Court did not provide convincing reasons for holding that the duty of care referred to in s. 122(1)(b) actually extends to creditors (in this thesis, tort creditors). Mohammed F. Khimji opined that the Supreme Court in *Peoples* only accorded a duty of care to creditors based on the fact that section 122(1)(b) of the CBCA does not specifically state to whom the duty of care is owed. In his view, such a reason is unmeritorious as it only shows the wide coverage of the duty of care provision over the duty of loyalty provision. It is not sufficient to extend the duty to

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[249] *Ibid.* paras. 67 and 71.
[250] *Peoples Department Stores (the Trustee of) v. Wise* [2003], 224 D.L.R. (4th) 509 paras. 74-76 (C.A.). See also Stephane Rousseau, "The duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the *Peoples* Case" (2003) 39 Can. Bus. L.J. 368 at 375.
[251] [1975] S.C. 260 at 265, cited by *Peoples (C.A.) ibid.* para. 73.

creditors.[252] That said, directors will obviously owe a duty of care to third parties at common law, on the right facts.

In short the Supreme Court has not barred the introduction of the culpability approach suggested. Beyond this, in the 2008 ruling in *BCE Inc., et al. v. A Group of 1976 Debentureholders, et al.*, the Supreme Court promised to give written reasons for overturning the appellate court's decision which relied on the *Peoples* Case. The lower court, while following *Peoples*, held that certain debentureholders' interests were entitled to fair consideration by the directors who had, in turn, failed to meet this standard.[253] More specifically, the Supreme Court promised to clarify the reach of *Peoples*. Until then, *Peoples'* impact on the proposed culpability test remains to be seen.

4.6 Conclusion

The previous sections have highlighted the peculiar challenge presented by negligence cases in a bid to form a general theory for resolving directors' personal liability in tort to third parties. The workability of the culpability theory has been measured on the scale of key Canadian cases thereby showing how this calibrated approach helps form a just compromise between the sometimes competing objectives of tort law and corporations law. It also advances the fairness and efficiency values of the progressives and the law and economic

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[252] Mohammed F. Khimji, "*Peoples v. Wise* – Conflating Directors' Duties, Oppression, and Stakeholder Protection, Case Comment (2006) 39 U.B.C.L. Rev. 209 at 223 – 224.

[253] *BCE Inc., et al. v. A Group of 1976 Debentureholders, et al. and Director Appointed Pursuant to the CBCA, Catalyst Asset Management Inc. and Matthew Stewart* [2008] S.C.C.A. No. 202 overrulling *BCE Inc., et al. v. A Group of 1976 Debentureholders, et al. and Director Appointed Pursuant to the CBCA, Catalyst Asset Management Inc. and Matthew Stewart* [2008] QCCA 935.

movements. This new approach could work to at least reduce the confusion which marks the Canadian common law to date.

PART V GENERAL CONCLUSION

The current law governing directors' liability in tort to third parties is confused and founded upon competing theories and values. One line of cases, based on *ScotiaMcleod*, elevates corporations law values and economic efficiency. The other line of cases, based on *Adga*, upholds tort law values and fairness. This creates a most unsatisfactory situation at common law because directors cannot have a clear understanding of when liability will attach, particularly in the realm of negligence.

In response, this thesis has offered a theory of directors' liability based on the notion of culpability. That is, directors should be held liable for corporate torts based on the degree of fault on their part. In essence, liability should attach only in cases of intentional and gross negligence while ordinary negligence should not attract liability.

When this theory is applied to Canadian case law, it provides a reasonably bright light as to when directors should anticipate liability and when they should not. With the exception of inducing breach of contract, liability will ordinarily accompany the commission of an intentional tort. Liability in the realm of negligence is calibrated according to whether the conduct approaches the intentional (by taking the form of gross negligence) or manifests itself in ordinary negligence. Liability would ordinarily accompany the former (due to the enhanced degree of culpability) but not the latter. In this way the often-competing values of tort law and corporations law find an appropriate level of accommodation.

It is hoped that the Supreme Court will clarify the matter of directors' liability to third parties soon. When it does, it is important that the court not place too much emphasis on upholding the principle of corporate personality at the expense of the proposition that all persons must be responsible for their own wrongful action or *vice versa*. Rather, the court should measure culpability and dispense justice by balancing the values of fairness and economic efficiency. Canadian jurisprudence requires a corporate legal regime, which, as much as possible, makes directors pay for their wrongs while not penalizing individuals who are only performing their corporate duties.

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